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U.S. SYNTHETIC FUELS CORPORATION'S PROPOSAL TO AWARD THE GREAT PLAINS PROJECT $820 MILLION IN ADDITIONAL FEDERAL FINANCIAL ASSISTANCE

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HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

MAY 22, 1985

Printed for the use of the Committee on Government Operations

U.S. GOVERNMENT PRINTING OFFICE
50-496 O WASHINGTON : 1986

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U.S. SYNTHETIC FUELS CORPORATION'S PROPOSAL TO AWARD THE GREAT PLAINS PROJECT $820 MILLION IN ADDITIONAL FEDERAL FINANCIAL ASSISTANCE

WEDNESDAY, MAY 22, 1985

House of Representatives,
Environment, Energy,
and Natural Resources Subcommittee
of the Committee on Government Operations,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2154, Rayburn House Office Building, Hon. Mike Synar (chairman of the subcommittee) presiding.

Present: Representatives Mike Synar, William F. Clinger, Jr., Thomas D. (Tom) DeLay, and Richard K. Armey.

Also present: Sandra Zeune Harris, staff director; Eric R. Young, professional staff member; Becky Meadows, clerk; and James B. Tapper, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN SYNAR

Mr. **Synar**. The subcommittee will come to order.

Today the Subcommittee on Environment, Energy, and Natural Resources will review a proposal by the U.S. Synthetic Fuels Corporation to award an additional $820 million in Federal assistance to the Great Plains Gasification Project in Beulah, ND.

The subcommittee's longstanding interest in the Great Plains project has stemmed from the enormous amount of taxpayers' dollars that have been invested in Great Plains. To date, the project's sponsors have borrowed almost $1.5 billion of taxpayers' money.

Our interest has also centered on Great Plains because it is our Nation's first large commercial-scale synthetic fuels plant under operation. As our colleague, House Majority Leader Wright, so aptly stated at the subcommittee's October 1983 hearing on this subject, Great Plains is the "first big fruit from the tree that we planted back in 1980."

The issue at hand today is not whether or not we shall have Great Plains but, rather, the manner in which we shall have Great Plains. The project is built. The taxpayers' money is spent. Yet, despite the well-managed construction and encouraging technical operations, this project has been, and continues to be, a financial nightmare. It is simply not economic under anyone's expectations.

The bottom line is that the sponsors cannot operate Great Plains and service their debt to the taxpayers of $1.46 billion. To get their money back, we are now told that we must spend more taxpayer dollars. It is an unfortunate predicament that we face.

I am reminded of the advice offered by Mr. Robert Thomas, then-chairman of the Great Plains Gasification Associates, during the subcommittee's 1983 hearing. In discussing the sponsors' primary concern about further investments in the project at the time, he said, "Sunk costs really are sunk, and throwing good money after some that has turned bad only makes a bad situation worse."

Nonetheless, we will listen today to contrary advice—advice suggesting that the Government invest more taxpayer dollars in this project. What this additional investment will buy us, and how much of the taxpayers' money has been lost forever, are questions we will address today.

They are questions, however, that go beyond the bottom line financial loss this project represents to the taxpayers. They go to the very heart of the ongoing debate over our current Synthetic Fuels Program. Unless and until industry is willing to accept an equitable portion of responsibility and risk in developing synfuels technology, this program will remain forever hostage to a lifeline of Federal subsidies.

In response to the sponsors' announced intentions to abandon Great Plains absent additional Federal financial assistance, the Synthetic Fuels Corporation began negotiating a price support package in February of last year. Just recently, the SFC staff presented the Corporation's Board of Directors with a proposal to award Great Plains an additional $820 million. It remains unclear, however, whether the current Board at SFC can take legal action on this proposal. Two of the five Directors may have conflicts of interest which could prohibit any final Board determination. The issue of conflicts among Board members is not a new one to the Synthetic Fuels Corporation. Indeed, it is one that has plagued the SFC's history.

The subcommittee requested the appearance at today's hearing of two Directors whose financial interests are at question. Unfortunately, those two Directors, Mr. MacAvoy and Mr. Reichl, chose not to appear. Their decision is unfortunate because it reveals, I believe, a lack of regard for the responsibilities incumbent upon Federal officials.

As I have often said in the past, the success of this program, as with any Federal program, is dependent upon the credibility of the decisions being made and those making them.

We will review the situation with respect to a Board decision on Great Plains, in an effort to determine whether such credibility can be maintained.

The subcommittee will receive testimony from representatives of the General Accounting Office, the Synthetic Fuels Corporation, the Department of Energy, and the project sponsors—the Great Plains Gasification Associates—as we review various options available to the Government for proceeding with the Great Plains project.

In closing, I want to express my sincere hope that an acceptable and equitable arrangement can be reached on this project. I believe it will require a commitment from both parties—the Government and the sponsors—to share the burden of resolving a problem for which each is equally responsible.

We are also pleased today to receive a statement from our good friend and colleague, Congressman Byron Dorgan. But before we turn to Mr. Dorgan, let me call on my ranking minority and dear friend, Bill Clinger, for any opening remarks that he might have.

Mr. CLINGER. Thank you very much, Mr. Chairman.

I just want to begin by stating what is abundantly obvious: This is a very complex subject which warrants careful consideration by this subcommittee. We are indeed dealing with taxpayers' dollars, as you have indicated, but we are also moving in the realm of private sector contract negotiations.

In trying to encourage private-public sector cooperation, we have to be mindful of the proper role of Government. Here, of course, our proper role is oversight. And today we are going to be looking into the alternatives to financing the Great Plains Coal Gasification Project and the relative cost to the Government associated with supporting that project.

I want to stress that in no way should it be the intent of this subcommittee to interfere with contract negotiations or to attempt to influence them. Having said that, I want to take just a moment, Mr. Chairman, to comment on the Synthetic Fuels Program in the United States. Information we have been gathering in this subcommittee and in this Congress shows that evidence is mounting that the United States may very well face an energy crisis before the end of this century.

Studies recently released by the Interior Department and the Office of Technology Assessment point to a sharply declining offshore reserve base—a decline since 1981 of 55 percent for oil and 44 percent for natural gas. Domestic exploration is falling, finding rates are down, and imports are once again rising.

The so-called oil glut has directed our attention away from these trends and created a false and, in my view, dangerous sense of complacency. That is why, Mr. Chairman, I think we must turn our attention to providing an efficient and productive Synthetic Fuels Program for the United States. We have the time now before we become too susceptible to supply interruptions and become forced to turn to synthetic fuels in the wasteful haste of a crisis situation.

In that respect I want to point out, Mr. Chairman, that the Synthetic Fuels Corporation has begun a new approach to our Synfuels Program which is embodied in their comprehensive strategy, and which I believe goes a long way toward putting an admittedly floundering program back on the proper track.

What I hope and believe we will hear today is how the Great Plains project fits into that new approach and how Government involvement can yield the technological data to further the energy independence of the United States—the goal that we all seek. We, indeed, want the biggest bang for our buck in this program, and we would like to hear the opinions of today's witnesses on how to get it from Great Plains.

Thank you, Mr. Chairman.

Mr. SYNAR. Thank you, Bill.

Mr. Armey, for an opening statement?

Mr. **Armey**. Mr. Chairman, I have a prepared statement I would like to enter in the record.

Mr. **Synar**. Without objection, it will be included.

Mr. **Armey**. I would like to make a few comments. I am obviously very interested in this because as a youngster I shoveled coal from the coal fields at Beulah, ND.

On the other side of the coin, as a conservative economist, I have no feelings of endearment toward the concept of Government being involved in an enterprise that I believe to be private enterprise in nature. Certainly, Government price guarantees are objectionable to me as an economist. Nevertheless, we have made a heavy investment in this activity and it does show technological promise. Energy independence is something very important to the future of this country. I think this perhaps gives some justification to the kind of investment we have made. I am going to find this, I think, a very fascinating hearing, and one that will give me an opportunity to sort conflicting points of view even in my own mind.

I look forward to the testimony and I appreciate your calling this hearing on this important subject. Thank you.

[The opening statement of Mr. Armey follows:]

OPENING REMARKS

THE HONORABLE RICHARD K. ARMEY

Thank you, Mr. Chairman. I'm pleased that the Subcommittee is looking into the price guarantees proposed for the Great Plains Coal Gasification project. In doing so, it presents us with the opportunity to examine not only Great Plains, but also to examine this nation's need for and commitment to synthetic fuel development.

I am excited about synthetic fuels development and the contribution which synthetic fuels can make toward helping us to meet our energy needs. I must say up-front, however, that I believe our economy and our long-run energy requirements would have been better served if the government had stayed out of the decision-making process, and the decision to develop, produce and use synthetic fuels had been left to market forces.

Today, we are meeting to discuss proposed Synthetic Fuels Corporation assistance to the Great Plains Coal Gasification project. Specifically, we are talking about $820 million in price guarantees to a plant which has already received $1.46 billion in federal loans. I understand that the prior commitment and the assistance given to Great Plain's partners was made by the Department of Energy and not by the Synthetic Fuels Corporation. I also realize the time period--and the concerns of the period--in which that commitment was made.

As an economist, there are few things which I find more distasteful than government price guarantees. Government price guarantees create disincentives to private sector development; they misdirect scarce capital away from more productive uses, and they restrict competition. They are a costly expense to already overburdened American taxpayers, and they are an affront to our free enterprise system.

Since the passage of the Energy Security Act, which created the Synthetic Fuels Corporation and the interim DOE program, world oil conditions have changed. So too--as I often find myself pointing out--has our federal budget. I am concerned about energy independence, and with having enough energy to meet our economic and defense needs. However, I am also painfully aware of the need to examine every request for federal dollars, and to exercise every opportunity to eliminate or reduce outlays.

With 20/20 hindsight, it appears apparent that the Great Plains Coal Gasification project was too large a venture. The original goal of the Synthetic Fuels Corporation was to make synthetic fuels a possibility; to create a public/private partnership which would prove the technology and work out the problems so that a synthetic fuels alternative would be available to address future energy supply problems. I think we went too far with the commitments which we made, and I think we are paying the price of those mistakes today.

Someday, oil and gas prices will rise and synthetic gas will be competitively priced. When, we don't know. The Synthetic Fuels Corporation's own analysis appears to indicate that it will be a decade or more before the Great Plains Coal Gasification project produces an economical product. Yet, from what I understand, the partners who make up the project expect the $820 million in price guarantees to last for only four or five years. What happens then? What if synthetic gas is not competitively priced and the partners pull out? Will we again be faced with the need to provide additional subsidies or lose our entire investment?

Mr. Corcoran has said that Great Plains "is a technical success," but a "financial disaster." What I'm wondering, given the objectives of the SFC, is what $820 million in price guarantees will buy us? It won't give us competitively priced gas, and, as far as I can see, it won't get us any major technological advances.

The Oil Daily editorializes that "it's unlikely that the United States will soon achieve such an ideal state for synfuels development. What remains, then, is the need for the companies themselves to consider the long-term rewards of going against the prevailing atmosphere and forging ahead on developing synfuel technology. They are the ones who, in fact, may emerge the long-term winners by showing their willingness to pay a short term price."

I believe this is sound advice, and reflects the market-directed strategy I referred to earlier. Sure there are risks, but there are rewards too. And I am confident that private companies seeking to make a profit can and will create an efficient and viable synthetic fuels industry.

Mr. SYNAR. Thank you very much, Dick.

It gives me great pleasure to introduce one of the people I count as one of my closest friends in Congress, a dear colleague of ours and a big supporter of the project, Congressman Byron Dorgan. Byron, welcome.

STATEMENT OF HON. BYRON L. DORGAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Mr. DORGAN. Thank you, Mr. Chairman.

I am pleased to be here and I will present a very brief testimony today. I would like to offer a statement, the entire content of which I would hope you would include in the record.

Mr. SYNAR. Without objection, your entire testimony will be made part of the record.

Mr. DORGAN. I know the chairman of this subcommittee is sensitive to this country's energy needs. He comes from a State with pumping oil wells not only in the State capital, but actually on the State capitol grounds. So you can't come from where the chairman comes from without being sensitive to this country's energy picture.

I was interested in your statement, Mr. Chairman, and the statement of Mr. Clinger and Mr. Armey. Mr. Clinger particularly pointed out something that I think is important for us to remember and understand: We still have a long-term energy problem. There are people in this town involved in the development of public policy who will state that inflation is gone. It isn't. They will also state that our energy problems are over. They aren't. We still have a long-term energy problem that we must prepare for and respond to. That's the reason I am here.

Frankly, I did not support former President Carter's proposal that we ought to have a giant basket of synthetic fuels plants in this country. I didn't think we ought to put all our eggs in one basket. But I do believe that in order to prepare for the day when we have to decide how we are going to either go it alone or dramatically expand our production, we ought to develop commercial-scale production of various energy technologies. These technologies include coal gasification, ethanol alcohol, geothermal and dozens of other applications. I believe we need to have commercial-scale operations of these technologies so that we can evaluate their potential for this country's future energy supplies.

Part of the evaluation process includes Government encouragement for a consortium of companies to build a coal gasification plant. This was not a small undertaking. We are talking about the investment of hundreds of millions of dollars by the consortium and loan guarantees by the Government. This plant just didn't grow from the prairies as a stalk of corn would grow—it was developed with the active encouragement and participation of the Federal Government.

The Governor and I flew over the Great Plains Gasification Plant on Saturday while I was in North Dakota. As Mr. Armey indicated, the plant is located in a sparsely populated area. When you look down and you see that kind of facility, it is really a staggering sight. It is not just some ma-and-pa plant. It is one of the largest industrial enterprises undertaken in this country.

I am nervous about what I see and hear, for this reason: We in North Dakota have had the opportunity to fly over our State in the past and look down on a $1 billion project that was magnificently built and then quickly abandoned. That was a project that I didn't think ever should have been built. It was the ABM project, the free world's only antiballistic missile system. A billion dollars were spent up there on the prairie. It looks like the world's largest bunkhouse now, except there's nobody around to bunk—it's just empty. It was emptied 30 days after it was completed. So, we understand up there about projects that cost a great deal of money, and as a matter of public policy, are encouraged and then quickly abandoned.

I am nervous because of that experience. In this case the development of a commercial-scale coal gasification plant, which was encouraged by public policy, and in my judgment, still justified by public policy, could, because of the failure of the correct public policy in this town, be ultimately abandoned. It could happen. If it does happen, it will be a step backward for this country because I believe this is the opportunity for Americans to understand what a commercial-scale coal gasification plant can provide for this country's future.

Frankly, I don't know what this might provide in the mix of future energy sources, but I want to know, and I think this country wants to know. I think this country needs to know. This is the opportunity.

Mr. Chairman, you indicated in your remarks at the start of the hearing, although you didn't say it quite this way, but I believe you were suggesting that it isn't whether the plant is going to be completed and financed in a way that it will continue to operate in the long term, but it's a question of how. I was encouraged by that, because I think if all of us understand at this point that it would be a colossal failure for us to let that plant be abandoned and stand there as a shell when it could be a commercial demonstration for us and to us about our future energy capabilities from our fossil fuels. If we all start with that same position, then perhaps we can avoid the tragedy of having that kind of investment and those opportunities that are embodied in that investment denied for our evaluation in the years ahead.

I have some information in the testimony I have given you. You have a lot of people who will testify that will provide specific data but I just wanted to provide those comments at the start of your hearing. I appreciate the courtesy of the subcommittee for hearing me.

[The prepared statement of Mr. Dorgan follows:]

Statement of the Honorable Byron L. Dorgan (D-ND)

Before

the Environment, Energy, and Natural Resources Subcommittee
of the House Governmental Operations Committee

Good morning, Mr. Chairman. I appear here to support the U.S. Synthetic Fuels Corporation's efforts to negotiate a price guarantee for the Great Plains Gasification Project to ensure that this major pioneer plant proceeds and provides the nation with vital learning benefits. The Great Plains Gasification Project, located near Beulah, North Dakota, is the largest synthetic fuels plant currently under construction in the United States. It is sponsored by five large gas pipeline companies and is designed to produce some 45 billion cubic feet per year of synthetic natural gas using North Dakota lignite as its feedstock. It has provided -- and will continue to provide -- nearly 1,000 direct jobs for my state, and many more indirect substantial tax revenues.

At full capacity, the project will produce approximately 137 million cubic feet per stream day of high Btu synthetic gas from 14,000 ton per day of lignite using the Lurgi coal gasification process. This is the equivalent of 23,000 barrels of oil each and every day. The project was built on time and under budget; start-up operations, which began in July, have been relatively smooth, and problems which have arisen are being corrected.

It is important to the nation's long-term energy future that Congress do nothing to interfere with the negotiations currently underway between the Great Plains' sponsors and the U.S. Synthetic Fuels Corporation. Because of the decline in energy prices since 1982 and the consequent increased probability of project abandonment, Great Plains has requested price guarantee assistance from the Corporation over and above the loan guarantee it received from the U.S. Department of Energy. This request is now the basis for intensive negotiations between the project and the Corporation, and I feel it is imperative that this project not be jeopardized by the inclination of certain of our colleagues to join the negotiations as uninvited third parties.

I believe this project is important for a number of reasons:

1. The project can make the largest, earliest, and most cost-effective contribution to the energy goals of the Energy Security Act of any domestic synthetic fuels project.

2. The project will for many years provide definitive information on the technical, environmental and socioeconomic aspects of a commercial, coal-based synthetic fuels project.

3. The project has been built under budget and on schedule.

4. However, based on current oil price projections, the project sponsors face the unacceptable prospect of substantial after-tax losses and negative after-tax cash flows during at least the first decade of the plant's operations.

5. The SFC alone has the responsibility, the authority, and the funds under the ESA to provide price guarantees as needed by the project.

6. The project sponsors are not seeking restoration of their original income and cash flow expectations. They seek only a restructuring of the present government support commitment to include price guarantees which will enable them to complete and operate the project.

7. Last April SFC executed a non-binding letter of intent with the project. Under terms of the letter of intent Great Plains sponsors must invest another $100 million in the project and must accelerate the payback of the DOE loan guarantee. These economic adjustments to the DOE contract would significantly reduce the chances that the sponsors would default on the federally guaranteed loan. Additionally; as I understand it, under the deal presently under consideration, the sponsors would be required to put up an additional $190 million in return for up to $820 million in price guarantees. The project will pay to the federal government 75% of all after tax cash flow from the project once the DOE loan has been paid off for as long as the project operates.

In short, Mr. Chairman, this project is important to the future of long-term energy security of this country. It is ont of the largest industrial projects ever undertaken -- and was built on time and on budget. It will demonstrate to others that this nation is serious about developing its solid fossil fuel reserves which comprise some 85% of our domestic energy supplies. This project has been referred to by one of our distinguished colleagues as the "crown jewel" of our synthetic fuels collection and should be supported by all of us to ensure substantial future energy supplies for future generations of Americans. Thank you for this opportunity, Mr. Chairman.

Mr. SYNAR. Thank you very much for your comments. They are always very helpful for our subcommittee. As I said, your entire remarks will be made a part of the record.

Mr. Clinger.

Mr. CLINGER. Thank you very much, Mr. Chairman.

I would also like to thank our colleague, Mr. Dorgan, for an excellent statement.

We talk a lot about energy independence and some of these macro issues, but what does this project mean to your State in terms of employment, in terms of development of coal resources, those kinds of issues?

Mr. DORGAN. It goes without saying, the project is important to our State. But I hope that I would be good enough to be here opposing it if I thought it was a real boondoggle. I actively opposed the ABM system, and it, too, was important to the State from an economic standpoint and from a job standpoint, but I thought it was a waste of money and I opposed it.

I support the Great Plains project because I think it is important for the country. And, yes, it is important from an economic standpoint because we have, as Mr. Armey mentioned, we have those vast lignite coal beds which are part of the largest deposits of low sulfur coal in the world. We hope, ultimately, to be able to use those resources in the development of an energy independence, or at least a step for energy independence for this country.

Mr. CLINGER. You indicated that the issue here today is not whether this project will go to completion, go to full production, but how we can best accomplish that with the least exposure of the Federal Government.

In your view, if the present partners are to abandon the project, or were to abandon the project before going online, what realistically do you think are the chances that the project would go forward, and that we would see production from that facility?

Mr. DORGAN. My concern is that if there is an abandonment, I don't see the kind of initiative and the kind of political movement that would be necessary in our Government to say, "all right," as an affirmative measure we are going to go forward and continue production.

Mr. Clinger, let me point out that production has commenced. I am sure others will testify today that this plant is online; it is producing. The question is whether we come up to a point at which the consortium would want to exercise its right of abandonment. And, of course, with the deteriorating price of energy in the past couple of years, and the facing of substantial losses, at least under the worst case scenarios, you might have a case where the consortium would want to exercise their right in absence of price guarantees.

If that happenend, I think there is a danger of there being a vacuum and no one coming in and picking up the initiative to continue it.

Mr. CLINGER. Just one final question.

These plants have been controversial in the past in terms of whether or not they are good neighbors, whether or not they are compatible with their environment. In general, what has been your feeling about the response of your constituents, citizens of the State, to the plant being there? Is it working well?

Mr. **Dorgan**. Generally, this has been a good experience. The consortium and the managing partners have done a good job upfront of explaining precisely what is happening all along the way, and trying to use as many local employees as possible. They really have done a good job of communicating. They have run into one problem that they have been working with the citizens and the State health department on which is an order problem during their startup. But I think they have been very forthcoming all along the way, and they have had a pretty good relationship with the people of the State.

Mr. **Clinger**. We thank you very much for a very fine statement.

Mr. **Dorgan**. Thank you.

Mr. **Synar**. Mr. Armey?

Mr. **Armey**. I have no questions but I would like to make a comment here. As Mr. Dorgan knows, I am now a Texan, and very proud to be a Texan, but you can never take North Dakota out of the boy altogether, and it is a pleasure for me to be here this morning to see you speak so enthusiastically on behalf of the State, the project, and the resources available in the State. I think you have done a good job this morning. I appreciate your appearing before us.

I am going to save my technical inquiries for the people that represent the SFC and the industry, but I enjoyed listening to you this morning.

Mr. **Dorgan**. Thank you, Mr. Armey.

Mr. **Synar**. Thank you, Dick.

Thank you, Byron.

Our first witness will be Mr. F. Kevin Boland, Senior Associate Director of Resources, Community and Economic Development Division for the U.S. General Accounting Office, accompanied by Ms. Mary Ann Kruslicky.

Let me welcome you both. Do either one of you have any objection to being sworn in?

Mr. **Boland**. No, Mr. Chairman.

Mr. **Synar**. If you would stand and raise your right hand.

[Witnesses sworn]

Mr. **Synar**. Thank you very much. Again, welcome, and let me take this opportunity to again thank you for the excellent work that you all have been performing for the subcommittee in this area. As always, you all do a tremendous job in assisting us and we look forward to your testimony. Your entire testimony, with unanimous consent, will be made a part of the record.

We have a lot of witnesses today so if you could summarize in about 5 minutes it would be very helpful to the committee.

STATEMENT OF F. KEVIN BOLAND, SENIOR ASSOCIATE DIRECTOR, RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY MARY ANN KRUSLICKY, EVALUATOR

Mr. **Boland**. Thank you, Mr. Chairman.

First, I would like to introduce Mary Ann Kruslicky, who is with me today, a GAO evaluator, who has been principally responsible for the work we have done over several months involving the Great Plains Gasification Project.

As you know, at your request, we previously reported on the financial status of the Great Plains project and testified before this subcommittee.

My prepared remarks today will focus on the financial assistance awarded the project by the Department of Energy, the tentative terms of price guarantee assistance with SFC, and an analysis of possible additional DOE assistance, and finally, the Government's options in the event of project abandonment.

By way of background, in January 1982, DOE awarded a loan guarantee to Great Plains Gasification Associaties for up to $2.02 billion of the originally estimated $2.76 billion cost to build a plant to produce commercial quantities of synthetic gas from coal. Great Plains agreed to finance the remaining costs with its own money or equity. As of May 1, 1985, Great Plains had borrowed about $1.46 billion under the loan guarantee agreement and had contributed about $490 million in equity.

The loan guarantee agreement requires Great Plains to annually submit an estimated cash-flow projection demonstrating its ability to repay the guaranteed loan and the project's profitability. The projection prepared in January 1982, when the loan guarantee agreement was signed, indicated a favorable financial outlook for the project and showed that the plant would be in a positive cash-flow position after 3 years of operation.

The cash-flow projections prepared since January 1982 showed significant changes in the project's financial viability including losses in net income, less distribution of funds to the partners, and larger capital investment requirements by the partners through 1996—the last year covered in the January 1982 projection.

The main reason for these changes was that the energy prices used to estimate the project's synthetic gas prices were lower than those used in January 1982. Previously, we reported that the project's finances were extremely sensitive to energy price changes.

In this regard, I would like to emphasize two important points. First, projections of future energy prices are very sensitive to economic conditions, international events, and domestic policy changes.

Second, Great Plains' financial analyses extend through the year 2009. Using energy price projections 25 years into the future greatly increases the speculative nature of financial analyses related to this project.

As a result of deteriorating financial projections in the wake of declining energy prices, Great Plains applied to SFC for additional assistance. In April 1984, SFC tentatively agreed to provide Great Plains up to $790 million in price guarantee assistance. On April 22, 1985, representatives of SFC and Great Plains reached an understanding of revised tentative terms for financial assistance that included increasing the maximum price guarantee to $820 million.

As of today, however, these tentative terms have not been approved either by SFC's Board of Directors or Great Plains management.

Now I would like to turn to the April 1985 SFC proposal. The latest proposal increases the amount of price guarantee assistance and equity contributions from those set out in April 1984 but decreases the guaranteed gas price in the latter years.

Under these terms, Great Plains could receive up to $820 million in price guarantee assistance for up to 10 years. SFC agreed to guarantee gas prices of $10 per million Btu's through March 31, 1988, and $6.50 per million Btu's thereafter if the market price is less than the guaranteed price.

In exchange, between April 1, 1985, and March 31, 1988, the Great Plains partners would invest $90 million more in equity than set out in the April 1984 proposal.

On the basis of SFC's analysis of the revised terms and other changes cited above, price guarantees would be paid for 6 years—1985 to 1990—the same as expected in April 1984. Other impacts of the latest proposal, however, are less favorable than expected in April 1984. SFC's analysis shows that:

The DOE-guaranteed loan would be fully repaid in 1998—4 years later than expected in April 1984;

Profit sharing would begin 3 years later and net receipts would total about $1.3 billion compared to $2.6 billion previously projected; and

About $813 million of the loan principal would be repaid during the price guarantee period compared to $1.3 billion projected in April 1984.

Of the $2.02 billion that DOE guaranteed, Great Plains expects to borrow about $1.54 billion leaving a balance of about $480 million. You asked that we provide information on the impact of DOE's providing price guarantees to Great Plains assuming assistance levels of $480 million—the unused balance of loan guarantee funds—and $820 million, which is the amount proposed by SFC. You also asked that we provide information on the project's finances assuming continued operations with no assistance.

At our request, DOE, using its energy price projections and computer model, conducted these analyses. Except for the price guarantee amount specified and DOE's energy price projections, the assumptions used are the same as the terms proposed by SFC in April 1985.

The results of DOE's analyses for these assistance levels are shown for the project's cumulative after-tax cash-flow, the amount of debt outstanding, and the parents' cumulative book income through the year 2009—the last year of expected plant operations. The estimates are presented in undiscounted dollars and do not recognize the time value of money.

First for the cumulative after-tax cash-flow results. After-tax cash-flow represents the amount of cash generated——

Mr. SYNAR. Let me ask you to summarize those results at that point because we are going to have to run for a vote and I want to come into questions after we run to vote. If you could, summarize those results that you found.

Mr. BOLAND. I will, Mr. Chairman.

With $480 million in assistance, the cumulative after-tax cash-flow would be negative from 1986 through the year 2005.

With $820 million in assistance, the project would experience negative cumulative after-tax cash-flows from 1986 through the year 2004 except for 1 year, 1990.

Without assistance Great Plains would have a positive cumulative after-tax cash-flow during the first 5 years of plant operations. After that and through 2007, however, the project would be in a negative cumulative after-tax cash-flow position.

Under all three assistance assumptions, the project would experience its maximum negative cumulative after-tax cash-flow in the year 2001.

Concerning debt repayment:

With $480 million in assistance, the DOE-guaranteed debt would be fully repaid in 2005.

With $820 million in assistance, the DOE-guaranteed debt would be fully repaid in 2005.

With no assistance, the DOE-guaranteed debt would also be fully repaid in 2005.

From 1985 through 1989, about $694 million of loan principal would be repaid with $820 million in assistance, about $675 million with $480 million in assistance, and about $192 million with no assistance.

For cumulative book income:

With $480 million in assistance, the cumulative book income is negative from 1985 through 2003.

With $820 million in assistance, it is negative from 1985 through 2002.

And with no assistance, the book income is negative from 1985 through 2006.

With or without assistance, the maximum losses would occur in 1995; however, the amount of these losses differ.

I have some additional comments, Mr. Chairman, on options in the event of project abandonment you might want to cover during the question and answer period. Thank you.

[The prepared statement of Mr. Boland follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
Washington, D.C. 20548

FOR RELEASE ON DELIVERY
Expected at 10:00 a.m.
May 22, 1985

STATEMENT OF F. KEVIN BOLAND
SENIOR ASSOCIATE DIRECTOR
RESOURCES, COMMUNITY, AND ECONOMIC
DEVELOPMENT DIVISION
BEFORE THE
SUBCOMMITTEE ON ENVIRONMENT, ENERGY, AND
NATURAL RESOURCES
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to participate in this hearing concerning the impact of the U.S. Synthetic Fuel Corporation's (SFC's) proposed assistance on the finances of the Great Plains coal gasification project in North Dakota. At your request, we previously reported on the financial status of the Great Plains project[1] and testified before this Subcommittee.

My prepared comments today will focus on the financial assistance awarded the project by the Department of Energy (DOE), the tentative terms of price guarantee assistance with SFC, an analysis of possible additional DOE assistance, and the government's options in the event of project abandonment.

BACKGROUND

In January 1982 DOE awarded a loan guarantee to Great Plains Gasification Associates--a partnership of five companies (Exhibit A lists the partners and their percent of ownership)--for up to $2.02 billion of the originally estimated $2.76 billion cost to build a plant to produce commercial quantities of synthetic gas from coal. Great Plains agreed to finance the remaining costs with its own money or equity. As of May 1, 1985, Great Plains had borrowed about $1.46 billion under the loan guarantee agreement and had contributed about $490 million in equity.

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[1] Economics of the Great Plains Coal Gasification Project, (GAO/RCED-82-210, Aug. 24, 1983) and Financial Status of the Great Plains Coal Gasification Project, (GAO/RCED-85-70, Feb. 21, 1985)

The loan guarantee agreement requires Great Plains to annually submit an estimated cash-flow projection demonstrating its ability to repay the guaranteed loan and the project's profitability. The projection prepared in January 1982 when the loan guarantee agreement was signed indicated a favorable financial outlook for the project and showed that the plant would be in a positive cash-flow position after 3 years of operations.

The cash-flow projections prepared since January 1982 showed significant changes in the project's financial viability including losses in net income, less distribution of funds to the partners, and larger capital investment requirements by the partners through 1996--the last year covered in the January 1982 projection. The main reason for these changes was that the energy prices used to estimate the project's synthetic gas prices were lower than those used in January 1982. Previously, we reported that the project's finances are extremely sensitive to energy price changes.

In this regard, I would like to emphasize two important points. First, projections of future energy prices are very sensitive to economic conditions, international events, and domestic policy changes. Second, Great Plains' financial analyses extend through the year 2009. Using energy price projections 25 years into the future greatly increases the speculative nature of financial analyses related to this project.

As a result of deteriorating financial projections in the wake of declining energy prices, Great Plains applied to SFC for additional assistance. In April 1984, SFC tentatively agreed to provide Great Plains up to $790 million in price guarantee assistance. On April 22, 1985, representatives of SFC and Great Plains reached an understanding of revised tentative terms for financial assistance that included increasing the maximum price guarantee to $820 million. As of today, however, these tentative terms have not been approved either by SFC's board of directors or Great Plains management.

APRIL 1984 SFC PROPOSAL

Under the April 1984 SFC proposal, SFC agreed to guarantee Great Plains up to $790 million in assistance for up to 10 years. SFC agreed to guarantee gas prices of $10 per million Btu's for the first 3 years of the price guarantee period and $7.50 per million Btu's thereafter if the market price is less than the guaranteed price.

In exchange, the Great Plains partners agreed to contribute an additional $100 million in equity to the project and Great Plains agreed to repay the DOE-guaranteed loan faster and share profits with SFC (Exhibit B provides additional information on this assistance proposal).

SFC's assistance proposal would help to alleviate the impact of financial losses that could occur during the first 10 years of project operations (1985-94). The partners were concerned that the negative financial outlook during the first 10 years would affect their consolidated earnings, weaken their credit rating, increase their cost of capital, and drain capital from their other businesses. In February 1985 the Chairman, Great Plains Management Committee, reiterated that the partners gave more weight to these factors than to the speculative profits the project might generate in the future.

In the year since Great Plains and SFC signed the April 1984 tentative assistance agreement, several events have occurred that affected the final contract negotiations:

--Projections of future energy prices have been lowered.

- --Estimates of sales for one of the plant's products (carbon dioxide) have been reduced.

- --Estimates of operating costs have been increased.

- --The Internal Revenue Service (IRS) ruled favorably on the eligibility of the partners for production tax credits.

APRIL 1985 SFC PROPOSAL

On April 22, 1985, representatives of SFC and Great Plains tentatively agreed to revised financial assistance terms. Neither SFC's board of directors nor Great Plains management has approved these terms. The latest proposal increases the amount of price guarantee assistance and equity contributions from those set out in April 1984 but decreases the guaranteed gas price in the latter years. Under these terms, Great Plains could receive up to $820 million in price guarantee assistance for up to 10 years. SFC agreed to guarantee gas prices of $10 per million Btu's through March 31, 1988, and $6.50 per million Btu's thereafter if the market price is less than the guaranteed price.

In exchange, between April 1, 1985, and March 31, 1988, the Great Plains partners would invest $90 million more in equity than set out in the April 1984 proposal. (Exhibit C provides a comparison of the April 1984 and April 1985 terms.)

On the basis of SFC's analysis of the revised terms and the other changes cited above (for example, declining energy prices), price guarantees would be paid for 6 years (1985-1990), the same as expected in April 1984. Other impacts of the latest proposal, however, are less favorable than expected in April 1984. SFC's analysis shows that

- --the DOE-guaranteed loan would be fully repaid in 1998--4 years later than expected in April 1984,

- --profit sharing would begin 3 years later and net receipts would total about $1.3 billion compared to $2.6 billion previously projected, and
- --about $813 million of the loan principal would be repaid during the price guarantee period compared to $1.3 billion projected in April 1984.

ANALYSIS OF POSSIBLE ADDITIONAL DOE ASSISTANCE

Of the $2.02 billion that DOE guaranteed, Great Plains expects to borrow about $1.54 billion leaving a balance of about $480 million. You asked that we provide information on (1) the impact of DOE's providing price guarantees to Great Plains assuming assistance levels of $480 million (the unused balance of loan guarantee funds) and $820 million (the amount proposed by SFC) and (2) the project's finances assuming continued operations with no assistance.

At our request DOE, using its energy price projections and computer model, conducted these analyses. Except for the price guarantee amount specified and DOE's energy price projections, the assumptions used are the same as the terms proposed by SFC in April 1985. The results of DOE's analyses for these assistance levels are shown for the project's cumulative after-tax cash flow, the amount of debt outstanding, and the parents' cumulative book income through the year 2009--the last year of expected plant operations. The estimates are presented in undiscounted dollars and do not recognize the time value of money.

Cumulative after-tax cash flow

After-tax cash flow represents the amount of cash generated (including price guarantees received) by the project plus tax benefits available to the parent companies of the Great Plains partners. DOE's analysis showed that:

- --With $480 million in assistance, the cumulative after-tax cash flow would be negative from 1986 through the year 2005.

- --With $820 million in assistance, the project would experience negative cumulative after-tax cash flows from 1986 through the year 2004 except for 1 year (1990).

- --Without assistance Great Plains would have a positive cumulative after-tax cash flow during the first 5 years of plant operations (1985-89). After that and through 2007, however, the project would be in a negative cumulative after-tax cash flow position.

- --Under all three assistance assumptions, the project would experience its maximum negative cumulative after-tax cash flow in the year 2001.

The reason the no assistance cumulative after-tax cash flow is positive during the first 5 years of operations but negative with either $480 million or $820 million (except for 1 year--1985) in assistance is because SFC's proposal states that all cumulative after-tax cash flow for the first 2 3/4 years would be used to accelerate repayment of the DOE-guaranteed debt. Without assistance, Great Plains would retain these monies rather than reinvesting them in the project.

Debt Outstanding

Outstanding debt reflects the amount of both principal and interest remaining on Great Plains' guaranteed loan. Under each assistance option, the total amount includes the $1.5 billion guaranteed by DOE and the rest represents interest. DOE's analyses showed that:

- --With $480 million in assistance, the DOE-guaranteed debt would be fully repaid in 2005. Total principal and interest payments would total about $3.2 billion.

- --With $820 million in assistance, the DOE-guaranteed debt would be fully repaid in 2005. Total principal and interest payments would total about $3.1 billion.

- --With no assistance, the DOE-guaranteed debt would be fully repaid in 2005. Total principal and interest payments would total about $3.6 billion.

- --From 1985 through 1989, about $694 million of loan principal would be repaid with $820 million in assistance, about $675 million with $480 million in assistance, and about $192 million with no assistance.

Cumulative book income

Book income is shown on the parent companies' income statement as either profits or losses that result from Great Plains' operations. DOE's analyses showed that:

- --With $480 million in assistance, the cumulative book income is negative from 1985 through 2003.

- --With $820 million in assistance, the cumulative book income is negative from 1985 through 2002.

- --With no assistance, the cumulative book income is negative from 1985 through 2006..

--With or without assistance, the maximum losses would occur in 1995; however, the amount of these losses differ. With $480 million in assistance, the maximum loss would be $417 million; with $820 million, $241 million; and with no assistance, $843 million.

OPTIONS IN THE EVENT OF PROJECT ABANDONMENT

In the event the Great Plains partners abandon the project, the government could sell the plant or operate it under a contract with a private corporation. Both DOE and SFC have assessed the impact of these options using different dates and methodologies. Therefore, the results derived by DOE and SFC are not comparable.

DOE analyzed the government's net cash flows from selling the facility following abandonment in mid-1985 and December 1988, 1989, 1994, and 1999 assuming that (1) the gas pricing formula remained in effect and (2) the gas pricing formula was not enforceable if the partners abandon the project. In each case, DOE assumed the plant would be operated under contract with a private company for at least 1 year following abandonment to allow time to complete the procurement process. Further, DOE treated the $1.5 billion of guaranteed debt as sunk costs (costs incurred in the past that cannot be recouped). DOE's analysis of selling the plant after a mid-1985 or a December 1989 abandonment showed that the government's net cash flow would be $462 million and $419 million, respectively (assuming the gas pricing formula remained in effect). These cash flows improve for analyses conducted after 1989.

SFC--using its current energy prices--analyzed the cost to the government of selling the facility following a mid-1985 and a December 1988 abandonment assuming no assistance. SFC's analyses showed that the discounted cost to the government would be about $757 million and $680 million, respectively. Further, using two different energy price scenarios provided by Great Plains, SFC analyzed the cost of selling the facility following a (1) mid-1985 and December 1988 abandonment assuming no SFC assistance and (2) abandonment in December 1989 with SFC assistance. SFC determined that the discounted cost to the government could range from $860 million to $1.5 billion depending on the energy price projection used and the time abandonment occurred. In each case, SFC assumed the gas pricing formula would remain in effect and that the plant would be operated under contract with a private company for 1 year following abandonment.

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Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions.

EXHIBIT A

EXHIBIT A

GREAT PLAINS GASIFICATION ASSOCIATES

PARTNERS AND PERCENTAGE OF OWNERSHIP

	Percentage of equity
Tenneco SNG Inc. (an indirect subsidiary of Tenneco Inc.)	30
ANR Gasification Properties Company (a subsidiary of American Natural Resources Company)	25
Transco Coal Gas Company (a subsidiary of Transco Energy Company)	20
MCN Coal Gasification Company (a subsidiary of MidCon Corporation, formerly Peoples Energy Corporation)	15
Pacific Synthetic Fuel Company (a subsidiary of Pacific Lighting Corporation)	10
Total	100

EXHIBIT B EXHIBIT B

ADDITIONAL INFORMATION CONCERNING

SFC'S APRIL 1984 PROPOSAL

--During the first 3 years of the price guarantee period, the Great Plains partners would contribute all project-related positive cumulative after-tax cash flow (including that generated by price guarantee receipts) for Great Plains' use in accelerating repayment of the DOE-guaranteed loan.

--After 3 years, Great Plains would use 90 percent of project-related positive cumulative after-tax cash flow to repay the remaining loan balance.

--After the DOE-guaranteed loan is repaid, Great Plains would pay SFC 70 percent of positive cumulative after-tax cash flow to a maximum of $1.58 billion (March 1984 dollars).

EXHIBIT C EXHIBIT C

COMPARISON OF SFC ASSISTANCE TO GREAT PLAINS

	April 1985 proposal	April 1984 proposal
Price guarantee amount	$820 million	$790 million
Guaranteed gas prices		
Committed equity period	$10.00 per MMBtu	$10.00 per MMBtu
Thereafter	$ 6.50 per MMBtu	$ 7.50 per MMBtu
Committed equity period	2 3/4 years (July 1, 1985 - March 31, 1988)	3 years from July 1, 1984
Equity requirements	$190 million plus positive cumulative after-tax cash from April 1, 1985 through March 31, 1988	$100 million plus positive cumulative after-tax cash through July 1, 1987
Profit sharing		
Accelerated repayment of DOE-guaranteed debt	90% of positive cumulative after-tax cash	90% of positive cumulative after-tax cash
After debt is repaid	75% of positive cumulative after-tax cash	70% of positive cumulative after-tax cash

Mr. SYNAR. Thank you very much, Mr. Boland.

I think what we will do here is recess, and the three of us will go vote; we will proceed with the questions when we get back.

[Recess taken.]

Mr. SYNAR. The subcommittee will come to order.

We will proceed under the 5-minute rule.

Mr. Boland, as you pointed out, it is very difficult to reach judgments based on energy price projections covering some 20 or 30 years. With Great Plains it is particularly difficult because of the project's economic sensitivity to price fluctuations.

You have characterized some of the analyses done by the SFC and the Department of Energy. Could you describe for this subcommittee the relationship between the price projections used by the Synthetic Fuels Corporation, the Department of Energy, and the Great Plains sponsors?

Mr. BOLAND. Yes. Between 1985 and 1988, the DOE prices are higher than SFC. After that, beginning in 1989 and through 2009, SFC prices are higher. We don't have current prices from Great Plains, Mr. Chairman. The last prices we had were in 1984, and I believe at that time they were lower than both SFC and DOE.

Mr. SYNAR. So SFC is the highest, DOE is the middle, and Great Plains is the lowest?

Mr. BOLAND. That's right.

Mr. SYNAR. OK. How up-to-date are the Department of Energy's forecasts?

Mr. BOLAND. The estimates they are using now—the pricing estimates—are based on preliminary estimates from the National Energy Policy Plan. I understand the final estimates should be out in September, but they are using the most current estimates they have.

Mr. SYNAR. Now, you analyzed the impact of cutting the SFC's $820 million assistance package down to $480 million. And the $480 million figure represents the amount of unused loan authority which DOE is expected to have left over. Is that correct?

Mr. BOLAND. That's correct.

Mr. SYNAR. OK. Now, in comparing the impact of the $820 million assistance level and the $480 million assistance level, whose price projections did you use?

Mr. BOLAND. Department of Energy's.

Mr. SYNAR. In both cases?

Mr. BOLAND. Yes.

Mr. SYNAR. OK. Did you apply the same assistance format that SFC has proposed under the $820 million package to the $480 million option that you analyzed?

Mr. BOLAND. Yes.

Mr. SYNAR. OK. Now, using DOE's recent projections, how long would it be before the price supports would be exhausted under either scenario, the $820 million or the $480 million?

Mr. BOLAND. I believe under the $820 million it would be 6 years, and under the $480 million it would be 3 years.

Mr. SYNAR. All right.

Would you describe for the subcommittee the effect of reducing the assistance from $820 million to $480 million on the project's after-tax cash-flows between 1985 and 1989?

Mr. **Boland**. The difference would be about $100 million lower with less assistance over the 5-year period.

Mr. **Synar**. Now, after 1990, what happens to the after-tax cash-flow under DOE's projections?

Mr. **Boland**. The after-tax cash-flow is negative.

Mr. **Synar**. For how long?

Mr. **Boland**. Through, I believe it is 2004.

Mr. **Synar**. OK.

Does there appear to you to be much of an incentive for the sponsors to stay with the project after 1990?

Mr. **Boland**. Let me answer the question this way.

Mr. **Synar**. Let me ask you this.

Mr. **Boland**. OK.

Mr. **Synar**. Do you think the sponsors would abandon after 1990?

Mr. **Boland**. That's not an easier question, Mr. Chairman. [Laughter.]

Let me answer it this way. In our February 1985 report, we stated that the principal concern of the partners was the first 10 years of the project. They were concerned that negative cash-flows and negative book income, would reflect a negative financial position, affect their consolidated earnings, and maybe have some effect on their stockholders.

If the partners were to accept the results of DOE's analysis, I think there would have to be some concern because what that analysis shows is that there is negative after-tax cash-flow and negative book income during the first 10 years of the project.

Mr. **Synar**. Let me ask you this, maybe you can answer it this way.

Would you stay in an investment that goes negative from 1990 to 2000?

Mr. **Boland**. I guess I am not in a position to making business decisions. I have no opinion.

Mr. **Synar**. No; I mean would you?

Mr. **Boland**. Would I personally?

Mr. **Synar**. It's a hypothetical. Would you do it?

Mr. **Boland**. I guess I would be concerned about making that investment.

Mr. **Synar**. OK. If the sponsors were to abandon the project at the end of 1989, how much of the $1.5 billion would be repaid by then, under the $820 million and the $480 million options?

Mr. **Boland**. I will ask Ms. Kruslicky if she can provide that.

Ms. **Kruslicky**. Under the $480 million option that we looked at, $675 million of the loan principal would be repaid. Under the $820 million option, $694 million—or a difference of $19 million.

Mr. **Synar**. Not much of a difference, is there?

Ms. **Kruslicky**. No, sir.

Mr. **Synar**. Could you describe the effect of these two support levels on the parent company's book income between 1985 and 1989?

Mr. **Boland**. The difference is about—over a 5-year period—$138 million less with the lower amount of assistance.

Mr. **Synar**. Could you briefly explain why book income is so important a factor in this project's viability?

Mr. **Boland**. I think it relates a little bit to what I said before, that the partners are principally concerned about the financial position and how it looks during the first 10 years of the operation, and negative book income suggests negative financial viability.

Mr. **Synar**. Let me see if I can summarize here. What you are saying is that reducing the amount of the price supports from $820 million to $480 million would have a relatively minimal effect on the project's after-tax cash-flows over the next 5 years, and would only marginally affect the amount of debt repaid to the Government during this time. It could, however, impact the stock values of the parent companies; is that correct?

Mr. **Boland**. Yes; on either level of assistance you will not get a positive cash-flow, as shown by the analysis, during the 5-year period. The difference in the loan amount that is repaid is about $19 million.

Mr. **Synar**. So the real impact is on stock values?

Mr. **Boland**. That's right, to the extent you have negative positions in cash-flows and book values, it could affect stocks, I assume.

Mr. **Synar**. Thank you, Mr. Boland.

Mr. Clinger.

Mr. **Clinger**. Thank you, Mr. Chairman.

Mr. Boland, you noted that at the assistance level of $480 million, book values might be negative as they would be with an $820 million level, and that the total debt repayment schedule may occur at roughly the same time. But, didn't you also state that total losses to the partners would be over $200 million more at the $480 million level compared with the $820 million level?

Mr. **Boland**. Yes.

Mr. **Clinger**. You also stated that the partners are giving heavy consideration to their consolidated earnings in capital gains, so wouldn't that significantly higher total loss have a decided impact on whether or not the partners would stay in the project at this point or make a determination to abandon it?

Mr. **Boland**. I guess it is a business decision, Mr. Clinger, that would have to be made, again, as how they view the next 10 years, and how the future looks based on, again, a key item, and that's——

Mr. **Clinger**. Right, but from their point of view.

Mr. **Boland**. From their prospect.

Mr. **Clinger**. From our point of view maybe it's a wash.

Mr. **Boland**. That's right.

Mr. **Clinger**. Or nearly a wash. But from their point of view, isn't it pretty clearly less advantageous to them at the $480 million level?

Mr. **Boland**. I would think so.

Mr. **Clinger**. And that might have an impact on their decision. If they are to abandon, it seems to me we lose certain things. Clearly, even though the economics of the thing may be similar, we do lose the technological data that might be obtained if they were to go forward.

And, second, it seems to me that we do lose the earlier repayment of the DOE loan, which is contemplated under this restructuring. Is that not true?

Mr. **Boland**. It's true. There is a recapture of taxes that would come back in the case of abandonment, but you do lose the——

Mr. **Clinger**. You do lose the repayment?

Mr. **Boland**. You do lose the repayment.

Mr. **Clinger**. Because under this restructuring, we do have an acceleration of the repayment, do we not?

Mr. **Boland**. That's right.

Mr. **Clinger**. You said in response to the chairman that DOE debt repaid by 1990 would be nearly the same with $480 million or $820 million in price supports. But you also said that $480 million would only last 3 years, not the 5 years provided by the $820 million.

Mr. **Boland**. That's correct. The analysis shows that they would last 3 years under the 480 and 6 years under the $820 million.

Mr. **Clinger**. Six years under the $820 million?

Mr. **Boland**. Six years.

Mr. **Clinger**. So, wouldn't it be more likely that they would abandon before 1990 if the price supports run out?

Mr. **Boland**. It is a possibility.

Mr. **Clinger**. Yes, OK.

Thank you, Mr. Chairman.

Mr. **Synar**. Thank you, Mr. Clinger.

Again, Mary Ann and Kevin, thank you for a tremendous job. I cannot give you enough accolades for the excellent work that you have done, and you are to be commended. The subcommittee thanks you.

Mr. **Boland**. Thank you, Mr. Chairman.

Mr. **Synar**. Our next witnesses will be Hon. Edward Noble, Chairman of the U.S. Synthetic Fuels Corporation. He will be accompanied by Hon. Tom Corcoran, Vice Chairman; James Groelinger, finance officer; John Roberts, ethics officer, and Leonard Rawicz, the general counsel.

If all of you will please stand. Do any of you have any objection to being sworn in?

[Witnesses sworn.]

Mr. **Synar**. Welcome back, Mr. Noble. As you know, we have been here before. I don't know if you heard my opening statement, but I expressed regret that the other two Board members could not be with us today, since we do have questions about their potential conflicts of interest.

Your entire testimony will be included in the record and we would appreciate it if you would summarize in around 5 minutes so that we could get into the questions.

STATEMENT OF EDWARD E. NOBLE, CHAIRMAN, U.S. SYNTHETIC FUELS CORPORATION, ACCOMPANIED BY TOM CORCORAN, VICE CHAIRMAN; JAMES GROELINGER, FINANCE OFFICER; JOHN ROBERTS, ETHICS OFFICER; AND LEONARD RAWICZ, GENERAL COUNSEL

Mr. **Noble**. Thank you, Mr. Chairman, members of the committee. You have my written testimony which I would ask to have included in its entirety in the record.

Mr. **Synar**. Without objection.

Mr. **Noble**. It explains in some detail the proposal negotiated between the sponsors of the Great Plains project and the Corporation staff. This morning I would like to bring you up to date on the situation following our Board meeting yesterday.

The proposed assistance agreement with the Great Plains project was the major item of discussion. At this time the Board is not prepared to move ahead on the proposed agreement. As you probably know, the administration, through Energy Secretary Herrington, indicated its clear position that while it does not oppose a price support agreement, and believes it may well be required in this case, the administration does not have any interest in providing a large Federal subsidy for a brief period of operation.

The Corporation's Directors agree with the administration that the optimum assistance agreement would ensure long-term operation of the plant and make maximum additions to the synthetic fuels data base. Accordingly, the consensus of the Board was to respond to Secretary Herrington to the effect that the schedule for payments on the DOE guaranteed debt to the Federal Finance Bank must be extended.

I have copies of both Secretary Herrington's letter to me and my response to him on behalf of the Board which I would like to provide to the committee at this time.

[The letters follow:]

THE SECRETARY OF ENERGY
WASHINGTON, D.C.

May 21, 1985

Honorable Edward E. Noble
Chairman of the Board
U.S. Synthetic Fuels Corporation
2121 K Street, N.W.
Washington, D.C. 20586

Dear Mr. Noble:

In response to your letter of May 9, 1985, regarding the Great Plains Gasification Associates (GPGA) Project, I am pleased to provide you with the position of the Administration.

A price guarantee assistance agreement has been negotiated by your staff and the sponsors of GPGA. We are not opposed to a price support agreement. Indeed, we believe it may well be required in this case. However, there is no Administration interest in providing a large federal subsidy for a brief period of operation. Since the information gained from lengthy operation of the plant is the major national benefit from its operation, we believe every effort should be made in negotiating such an agreement to ensure long-term operation of the plant and maximum additions to the synthetic fuels data base.

The Department of Energy believes such an agreement is likely to have more tangible and intangible benefits for the U.S. taxpayers, the Nation, and the U.S. Government than if such agreement is not concluded with the sponsors and they terminate their participation in the Great Plains Project. The sponsors have indicated that they will terminate their participation in the Project if such agreement is not promptly concluded. There are some scenarios whereby an abandonment by the sponsors of their participation in the Great plains Project may provide a greater cash return to the U.S. Government, in its entirety, than proceeding with the price guarantee assistance agreement. However, the additional returns to the Government resulting from abandonment must be weighed against the tangible and intangible benefits of proceeding with the agreement, particularly when the uncertainties concerning the Government's ability to achieve such a greater return are taken into account.

In conclusion, we urge the Board of Directors of SFC to approve and execute an appropriate price guarantee assistance agreement with the sponsors of GPGA as soon as reasonably possible.

Yours truly,

John S. Herrington

United States Synthetic Fuels Corporation
2121 K Street, N.W. Washington, District of Columbia 20586 Telephone (202) 822-6600

May 22, 1985

The Honorable John S. Herrington
The Secretary of Energy
Washington, D. C. 20585

Dear Secretary ~~Herrington~~: John,

Deputy Secretary Boggs presented your letter of May 21 regarding the Great Plains Gasification Associates (GPGA) project to the Board of Directors of the U. S. Synthetic Fuels Corporation yesterday. Our Directors agreed with the Administration's position that the Board should approve and execute an appropriate price guarantee assistance agreement with the GPGA sponsors as soon as possible. They also agreed that the optimum assistance agreement would ensure long term operation of the plant and make maximum additions to the synthetic fuels data base.

Further, the members felt that the most positive way of obtaining long term operation of the Great Plains project was to restructure its debt repayment schedule. The schedule for payments on the DOE guaranteed debt to the Federal Financing Bank (FFB) must be extended. This would be consistent with successful operation of a first generation large-scale synfuels plant. Because of the heavy debt, proposed SFC price guarantees have had to be extremely large during the initial operating period of the plant. The debt interest and principal repayment schedule should be restructured to remove this impediment. Repayment of interest and principal must be postponed until the later years of plant operation when net operating income is likely to be available.

Rescheduling of payments to the FFB would allow project operations to go forward based on price guarantees that may be considerably reduced from those now in the proposed SFC agreement. Lower price guarantee levels would extend SFC support over a longer period, resulting in lengthy operation of the plant. Thus, to achieve the goals set out in your letter of May 21, the Administration, principally DOE and FFB, should provide a realistic schedule of debt interest and principal repayment.

The SFC is prepared to sustain a high level of negotiating activity over the next few weeks to produce "an appropriate price guarantee assistance agreement with the sponsors of GPGA." This will necessarily require daily interaction with those who will be undertaking to restructure the FFB payments. Therefore, I propose that you set up an ad hoc interagency task force of senior officials in the appropriate agencies in which the Corporation may participate. Only if we work closely together can we hope to expedite a resolution of this matter. Until I receive your response to this suggestion, I cannot commit the Corporation to further negotiations with GPGA.

Sincerely,

Ed

Edward E. Noble
Chairman of the Board

Mr. Noble. In view of yesterday's Board deliberations, the Corporation will not commit to further negotiations with the sponsors of the Great Plains project until we have the response of Secretary Herrington.

In the final analysis, Great Plains has always been, and remains, the responsibility of the Department of Energy. The Corporation has cooperated for the past 2 years—first, with DOE in providing them with financial analysis on the project, and then in negotiations with the Great Plains Gasification Association's sponsors to find the best solution to the project's very real problems.

We have dealt in good faith, as have the sponsors. We have understood that a successful resolution of the matter would require a compromise and a genuine commitment on the part of all involved to the ultimate success of the project.

I continue to believe strongly that the experience and knowledge gained from the operation of the Great Plains project will serve this country well. I sincerely hope that a solution will be worked out. This plant, together with Cool Water and Union, and perhaps one or two others, will enable us to show the rest of the world that the United States can use its massive solid fossil energy resources in a manner that effectively serves our long-term energy, economic and national security interests.

Thank you, sir. I would be happy to answer any questions.

[The prepared statement of Mr. Noble follows:]

United States Synthetic Fuels Corporation
2121 K Street, N.W. Washington, District of Columbia 20586 Telephone (202) 822-6600

Testimony of Edward E. Noble, Chairman
U. S. Synthetic Fuels Corporation
Before the Environment, Energy and
Natural Resources Subcommittee of the
Committee on Government Operations
May 22, 1985
Washington, D.C.

Mr. Chairman, Members of the Committee: I welcome the opportunity to discuss with you this morning the proposed assistance package negotiated between the Corporation and the Great Plains Gasification Associates (GPGA). As you know, the Corporation has spent a very long time, first analyzing whether the project needed additional assistance and then negotiating the appropriate type and amount of such assistance. An agreement was recently concluded at the staff level which is now being considered by our Board of Directors. I believe the proposed assistance package is a toughly negotiated agreement which complies fully with the Energy Security Act. I would like to review this proposed agreement with the Committee today, discussing in some detail its terms and conditions and its potential benefits for the country.

In September, 1983 the Department of Energy requested the Corporation to analyze the likelihood of sponsor abandonment of the Great Plains project, were it not to receive price guarantee assistance. The project already had a DOE loan guarantee, and was drawing capital from the Federal Finance Bank (FFB) of the Department of Treasury. Since then the Corporation has evaluated the project's financial needs and negotiated an assistance agreement to protect the federal interest and provide the country critical operating experience with this pioneer commercial coal gasification facility. Negotiations between the Corporation and the sponsors of the Great Plains project have taken some fifteen months and have culminated in a proposed deal which I would represent as tough but fair.

THE PROPOSED ASSISTANCE PACKAGE

The Corporation's principal concern has been and continues to be that this pioneer commercial facility operate over its lifetime in the private sector. When financial analyses indicated that, without some form of additional assistance, the sponsors would in all probability abandon the project, the Corporation sought to negotiate a level of assistance sufficient to prevent this. The plant must operate over the long term to develop the technical, environmental, and management data necessary for efficient, sound expansion of the industry at some future time in line with market forces or national security needs.

I would like to note here that, while the world is presently enjoying the benefits of very soft energy markets, few doubt that this will change. Energy markets have always been cyclic, and experience teaches that at some future point supplies will tighten and prices will rise again. How high and how permanent the price rise will inevitably depend on what alternatives the industrialized nations have developed during this period of energy abundance. One obvious alternative for the United States would be a proven synthetic fuel capability. A few operating commercial synfuel plants, like Cool Water and Great Plains and Union, would assure this country of the technical expertise, skilled managerial and labor force, environmental knowledge, and other infrastructure necessary for the efficient, rapid replication of synthetic fuel facilities.

The primary goal of negotiations has been the long term operation of the Great Plains project, and the approach has been that of a workout. Unlike potential new sponsors, the Great Plains' sponsors did not require incentives to make that initial large investment of capital to construct the project. They had already invested massive amounts of time, capital, and management effort to design and construct the project which is already in start-up. What was required was a minimum level of incentive (assistance) to encourage the sponsors to operate rather than abandon the project.

Under the assistance package negotiated, the sponsors have specific but different obligations and rights during four distinct segments of the project's commercial life. During the first segment, which covers approximately the first three years of the contract, the Corporation would guarantee to pay the difference between $10 per million Btu and the FERC tariff for synthetic pipeline quality gas, and the sponsors are obligated to contribute new cash equity of $190 million in addition to all of the after-tax cash flow, including tax benefits, generated by the project. During this initial three-year segment SFC price supports are estimated at $570 million and the sponsors' total equity contribution will approximate $580 million. The entire after-tax cash flow plus all of the new equity contributed must be utilized to pay the DOE guaranteed FFB loan back earlier than currently scheduled. At the end of this initial period the project's debt level will have been reduced by half. During this initial period when the sponsors are required to make heavy investment in the project, their ability to abandon is very restricted. For lawful termination the projected sum of after-tax cash flow from April 1, 1985 to December 31, 1989 plus the tax cost of abandonment, if abandonment were to occur on December 31, 1989, must be more negative than a negative $390 million.

The second time period begins after March 31, 1988 and reflects three major changes in the project. First, the SFC price guarantee for the synthesis gas drops to the difference between $6.50 per million Btu (versus $10 per million Btu) and the FERC tariff. Second, the sponsors for the first time are permitted to receive some return of their new equity; specifically, they are allowed to receive 100 percent of the project's after-tax cash flow until they

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have recovered the $190 million of new equity plus interest which they had to contribute during the initial contract period. Also, the sponsors' right of termination is eased; the test reverts to the "prudent business judgment" test in effect under the DOE loan guarantee agreement. The sponsors' incentive to continue the project is strong, however, because this is the first time that they are able to recover funds. In addition, abandonment at this point would require a substantial repayment of tax benefits derived from the project.

The third time phase of the contract commences when the sponsors have drawn out their $190 million plus interest, and continues until all of the DOE guaranteed FFB loan has been repaid. During this third phase, at the early part of which Corporation price supports are expected to expire, 90 percent of all after-tax cash flow must go to repay the DOE guaranteed debt; 10 percent of the after-tax cash flow is available for distribution to the sponsors. Under the Corporation's median price projections this provision would result in the repayment of the DOE guaranteed loan in or around 2000.

The fourth time period initiates once the loan has been repaid. In this final phase, 75 percent of the after-tax cash flow generated by the project goes to the Corporation in the form of profit-sharing payments, and 25 percent is available for distribution to the sponsors. This cash flow sharing continues for the duration of the project's operating life.

Broadly summarized then, in the early years of the proposed assistance package the sponsors have an obligation to contribute new equity and project generated cash flow and tax benefits and no right to receive any cash or tax benefits from the project. Later, after receiving back only the nominal amount of a portion of their contributions after execution of the price assistance contract and with no allowance for recovery of sunk costs, the sponsors are allowed to receive 10 percent of the project's after-tax cash flow. That level of cash flow receipts is maintained until all DOE guaranteed debt is paid. After that and for the life of the project, only 25 percent of the project's after-tax cash flow will be available to the sponsor. Clearly, this is not an arrangement that enriches the project owners. Rather, it is a loan workout which allows the sponsors some long term likelihood of recovering their large investment, allows the DOE and FFB to recover the federal loan to the project, and allows the country to gain operating experience with a major synthetic fuel technology on the Nation's major fossil resource, coal.

With respect to any added financial costs or risks to the government if the Corporation provides the negotiated assistance to the project, our analysis shows that, on a net present value basis, the government is generally no worse off whether abandonment occurs today or in 1989 or 1990, after the Corporation has provided several years of price supports. This is because in these early years of the contract the sponsors are making substantial new equity and tax benefit contributions to the project, and all cash, from the sponsors and from the Corporation, is going to pay down the project's government-held debt.

Concerning prospects for continued operation of the Great Plains facility, the sponsors have repeatedly stated that without price support assistance they will abandon the project. They have taken the actions necessary under the current DOE loan guarantee agreement to position themselves for the final two week notification period prior to abandonment. The sponsors have taken these actions because it is their judgment that under the current energy market outlook and without price supports, the project would operate with heavy and continuing losses.

With respect to alternative approaches to meeting the project's financial needs, these have been examined by the Corporation and by several federal agencies with interest in the matter. Their independent findings were discussed at length at our Board meeting yesterday, as were the key provisions, implications, and anticipated effects of the proposed Commitment to Guarantee document. The Board now has all of this information under advisement, and I would expect a final vote on the question shortly.

* * * *

In conclusion, as one director I can say today that, given present circumstances, I support the proposed assistance package. It is no secret that I opposed DOE's original agreement with this project in 1981 because I questioned the judgment of granting a $2 billion loan guarantee on the basis of projected energy prices for the next ten years. I considered basing a $2 billion loan guarantee on the projected price first of oil for five years and then of natural gas for the next five years to be a very tenuous judgment. Today, however, the project is built and operating, with a present debt to the FFB of almost $1.5 billion. This is the government's "sunk cost" in the project. I do believe, absent assistance, the sponsors will abandon. I do not believe that the government will be able at that point to sell the project for any amount even remotely approaching its real value. And I certainly do not believe that the government itself can operate the plant in an efficient or cost-effective manner.

Thus, whatever the case in 1981, today we have Great Plains on line and with a large federal debt. I support the proposed assistance as a workout in which both the sponsors and the Corporation invest additionally in the project to enhance its likelihood of achieving economic viability and continuing to operate in the private sector. And if we succeed in this, the real benefit will be to the country -- not merely in economic terms but, much more importantly, in terms of the technological, environmental, and management experience gained and the infrastructure established through the sustained operation of this major commercial synthetic fuel plant. The real benefit is that the country will have taken one very large, critical step toward greater energy security.

Mr. **Synar**. Tom, do you have a statement?

Mr. **Corcoran**. Mr. Chairman, let me just say I am happy to be here. Some 8 years ago, I began my service in the Congress by serving on this full committee. I never had the privilege and opportunity to serve on this subcommittee, but I am happy to be here to respond to any questions you might have.

Mr. **Synar**. We're glad to have you.

We will proceed under the 5-minute rule.

Mr. Noble, you have repeatedly testified in the past that one of the reasons Congress should allow the Synthetic Fuels Corporation to move forward with billions of dollars in taxpayers' commitments is that private industry, in response to the Energy Security Act, has invested literally billions of dollars of their own money. You have said, "The government must prove itself a consistent and reliable partner with industry."

Recently, before the Energy and Commerce Committee, on which I also serve, you indicated that private industry had spent as much as $2.4 billion on projects before the Corporation. Now, is it fair to assume that you include in that $2.4 billion estimate investments by the sponsors of the Great Plains project?

Mr. **Noble**. Yes, sir, I think that is correct. That number was furnished us by the Synthetic Fuels Council.

Mr. **Synar**. OK. I would like to explore that particular investment for a moment, if I could. The taxpayers now have $1.46 billion invested in Great Plains. Is that correct?

Mr. **Noble**. I think that is correct, yes, sir.

Mr. **Synar**. The Great Plains sponsors have invested $535 million at this point, is that correct?

Mr. **Noble**. I think that is correct. I have my financial officer here and he can correct me if that isn't, but I think that is correct, yes, sir.

Mr. **Synar**. Now, on their $535 million investment, the sponsors have benefited from the availability of some tax credits. Isn't it true that the sponsors thus far have had $128 million in investment tax credits available to them?

Mr. **Noble**. I will have to ask to see if that is correct. Mr. Groelinger? Jim Groelinger, our vice president of finance.

Mr. **Synar**. Is it true that about $128 million in investment tax credits have been available to the sponsors?

Mr. **Groelinger**. That would seem to be approximately the right number, yes.

Mr. **Synar**. They have also been able to reduce their taxes by $168 million by writing off interest during construction. Isn't that true?

Mr. **Groelinger**. They have had an ability.

Mr. **Synar**. Finally, the sponsors have been able to begin writing down the cost of the entire plant. Accelerated depreciation has totaled $351 million to date, thereby reducing the sponsors' taxes, assuming a 46 percent corporate tax rate, by an additional $162 million. Is that true?

Mr. **Groelinger**. They have had a depreciation. I don't have those exact numbers with me. That would seem to be in the right order of magnitude, yes, sir.

Mr. **Synar**. If I could get staff to put the chart up at this point.

[Chart shown.]

Mr. **Synar**. So, Mr. Noble, in fact, as this chart indicates, the sponsors have been able to take tax breaks greater than the amount of money that they have invested. The bottom line, then, is that the taxpayers have almost $1.5 billion sunk into Great Plains, and the sponsors really don't have any of their own money in it, do they?

Mr. **Noble**. I want to point out that if that project is abandoned, they have to pay those tax benefits back, and I believe that's correct.

Mr. **Synar**. The question is, Mr. Noble, right now they don't have any money in it, do they?

Mr. **Groelinger**. If I might, if we look at the moneys at risk in the project at this time, the sponsors have at risk the amount that they would have to pay in the event they abandoned the project today. That amount is in the order of $350 million. So they have a very substantial amount at risk as indeed does the Government. But the sponsors are not in a position where they are at no risk. They have very substantial risk.

Mr. **Synar**. I think it is important to determine exactly whose money has been invested in the project, and before we begin——

Mr. **Noble**. Congressman, we don't make the tax rules.

Mr. **Synar**. Thank you, Mr. Noble.

I think that it is important that we discuss how much of the taxpayers' money we are going to provide for these companies.

You testified about the commitment of the private sector to these projects and the need for the Government to honor these commitments. But as I look at that chart, I don't see a bottom line commitment. All I see right there is taxpayer's money.

Mr. **Noble**. Sir, that's your chart. As Mr. Groelinger said, they do have a very large amount of money at risk if this project is abandoned. That is the whole crux of the matter.

Mr. **Synar**. OK.

Mr. **Noble**. A large amount, some $350-odd million. So it is not insubstantial. While your chart has $22 million, the real figure is something like $350 million that is at risk.

Mr. **Synar**. Let me just ask you this: Do you think it would be appropriate, Mr. Noble, to revise your estimate of how much money private industry has invested in projects before the Synfuels Corporation? And do you really think that that figure of $2.4 billion you always use is a fair one?

Mr. **Noble**. Let me say, Congressman, those figures were furnished to us by the Synthetic Fuels Council. We do not, and I don't think anyone is privy to others tax books and exactly what credit they have taken for taxes. As I say, we don't make the tax rules. We are privy to the other figures. In this case, because we were allowed to, on a proprietary basis, look at the books, we do know these projects, at least in the Great Plains situation, approximately what they do have at risk. They have a great deal of money at risk at this time.

Mr. **Synar**. Mr. Clinger?

Mr. **Clinger**. Thank you very much, Mr. Chairman.

I wonder if I could ask unanimous consent to have an editorial which appeared in the Oil Daily earlier this month submitted in the record.

Mr. SYNAR. Without objection.

Mr. CLINGER. Thank you, Mr. Chairman.

[The editorial follows:]

Friday, May 3, 1985

THE
OIL DAILY

Editorial Views

Keeping Synfuels Going

WHEN THE CARTER administration created the Synthetic Fuels Corp. as a quasi-governmental agency that could spend as much as $88 billion in this century to develop alternative fuels, we lived in a different energy environment than now. The nation still was reverberating from the stunning oil shocks of the 1970s. We were a country cowed by the power of OPEC to manipulate oil prices, and worried about the extent and price of future energy supplies for our petroleum-deficient nation.

Our energy world now is one of excess supply, not shortage. There are those who believe OPEC is no longer the master of our energy future but simply a relatively benign participant. The price of gasoline, which has become the mark of energy sufficiency to some consumers, has been falling steadily, at least until very recently. So, from a political standpoint, all's right with the energy world.

However, one of the truisms of politics is that it responds much better and more often to current crises than to future threats. And that's one reason why there's a move in Congress, now joined by Rep. John D. Dingell, the strong-willed and legislatively powerful chairman of the House Energy and Commerce Committee, to abolish the Synthetic Fuels Corp. as an unnecessary relic of the energy crisis that is perceived to have ended with the 1970s.

Although that may sound like an idea whose time has come — and certainly we cannot disagree with Rep. Dingell's conclusion that the conduct of the SFC has been unacceptable — now is not the time to kill development of the U.S. synthetic fuel industry outright. Rather, it's time to do what former Rep. Tom Corcoran seems to be suggesting — to continue government's role in synfuels research while leaving it to industry to develop projects that appear to be economically feasible.

It's not fair to link the saving of taxpayer dollars that could result in the short term from abolishing the SFC to Reagan administration plans to cut back on social programs, as Rep. Dingell did in his remarks to the House Fossil and Synthetic Fuels Subcommittee. Carried to its ultimate, that logic would have the U.S. spending money only for social programs and neglecting the necessary expenditures for other needed government programs, including national defense.

So the real question is whether the SFC has, as Rep. Dingell also opined, served its purpose. The answer, of course, is that it has not, although one effect of establishing the corporation was to serve notice on OPEC and other energy exporting nations that the U.S. can shift its resources to meet an energy emergency, if need be. It makes more sense to continue to examine the potential for synthetic fuels — whether it's through this quasi-public corporation or through some small agency within the Department of Energy — during this period of crude oil excess than to take the usual political course and wait until our nation once more finds it necessary to declare war on energy — and then go on a war footing, which is what occurred in the late 1970s.

It's time for Congress to find a compromise on synthetic fuel development in this country that allows the search to continue while there's still time.

...The Need Will Be There

FURTHER verification of the dangers that can be exacerbated by a lack of preparedness came in *The Oil Daily* this week in an article by G. Henry M. Schuler, director of the Bartlett Program on Energy Security for the Center for Strategic and International Studies at Georgetown University. Although the article was designed primarily to discuss the questions of energy security raised by oil company takeovers, Schuler noted forecasts predicting oil imports to the U.S. this year will represent as great a percentage of consumption as they did at the time of the Arab oil embargo a dozen years ago. He also cited predictions that imports will equal the worst year of the 1970s by 1990 and exceed 50 percent by 1995.

(Incidentally, he pointed to the risks taken by current takeover target Unocal Corp., to develop, with federal help, a viable shale oil production plant at Parachute Creek, Colo., that could show how to use some of the country's estimated 600 billion barrels of shale oil.)

The point here is that there's a certain logical interaction between what is happening now in energy supplies and what will occur in the future — thus the need to continue to examine the future of synthetic fuels. It's necessary to remember what few people seem to know, that the U.S. is, after all is said and done, a nation deficient in crude oil reserves — but clearly not in total energy reserves. It could be said that this country is the OPEC of coal and shale oil reserves. The question is how to use them.

Mr. **Clinger**. Mr. Noble, in your prepared statement, you indicate that abandonment of the project at this point would require a substantial repayment by the sponsors of the tax benefits derived from the project. That, of course, is a factor in whether or not they are likely to abandon.

Do you have any idea of what amount of repayment of tax benefits would be required if abandonment were to occur at this time?

Mr. **Noble**. I think, as Mr. Groelinger has just testified, I believe it will be in the order of $350 million, sir.

Mr. **Clinger**. OK, that is the——

Mr. **Groelinger**. That is the amount that they would have to pay to the U.S. Treasury in the event they abandon the project today. That would represent the recapture of the unvested tax credits as well as a recapture through a complicated mechanism of depreciation that is not earned. They would have to pay to the U.S. Government today, in the event of abandonment, an amount of approximately $350 million.

Mr. **Clinger**. Thank you. Mr. Noble, or Mr. Corcoran, I understand that at your Board meeting yesterday there was some difference of opinion regarding the proposed contract negotiated by your staff. I wonder if you could both comment on your respective opinions on the negotiated restructuring that is under consideration here.

Mr. **Noble**. I will lead off and then let Tom speak. I do stand very firmly behind the agreement that was negotiated by the staff. However, the Board requires four people to vote in the affirmative. We have five Board members. We also took into consideration the letter which we had from the Department of Energy. As you notice, in my testimony, which was furnished a few days ago to you, I am also very concerned that we have what I consider a reasonable chance that these projects are going to operate after assistance for a number of years.

Now, you can't absolutely guarantee that because you can't guarantee what prices are going to be. But based on what we call our median scenario, which is a fairly conservative estimate, we felt in this agreement that we had a reasonable chance that this plant would operate for a number of years after the assistance. There's no assurance. But I think if there is to be real assurance that the project will operate for many, many years, then probably the debt does need to be restructured and I think that was basically the decision and difference that existed.

I don't think any of us are in disagreement that we would like to see the plant operate for a number of years. I think it was more a degree of difference rather than a real difference. In light of the feeling, of the administration and the DOE, we felt that if this was to be accomplished it might, on a more assured basis—I don't think anything is absolutely assured, but a more assured basis—then that debt need to be restructured.

Tom, would you care to comment, sir?

Mr. **Corcoran**. Congressman, I think a number of things happened yesterday with respect to the Great Plains project. As you know, and as has been indicated, the administration did appear and indicate that it could not support the price support agreement that had been developed by the management of the corporation.

I think the Board of Directors also turned it down—although we did not actually, as our Chairman indicated, take a vote on the proposal.

Mr. NOBLE. Excuse me. I don't know whether we turned it down. We just didn't have four votes to make it affirmative.

Mr. CORCORAN. Second, we recommended to the Secretary of Energy that an interagency task force be formed consisting of the agencies of Government that have a responsibility in this regard. We indicated our willingness to participate in order to find a better solution to the problem that the Great Plains project presented to not only the sponsors of the project but also the Government as well.

Third, I think that there were a number of defects in the proposed agreement. I would say that the principal defect was that it attempted to provide financial assistance in the form of a price support agreement to the project so that in the initial years of operation the debt would be paid down.

Speaking as one director, but I think representing more than one director, we felt that was a fatal flaw. We believe that the responsibility for the Great Plains project rests primarily with the Great Plains Gasification Associates. We believe that it is not in the public interest for one agency of Government to have its loan guarantee corrected as a result of action by another Federal entity of Government. We believe that instead, for a number of reasons, both programmatic and financial, that what should occur is that we should restructure the loan agreement which presently exists between the Great Plains Associates and the Department of Energy. We have offered our very sincere willingness and commitment to participate in that renegotiation so that the result would be that the project would operate long enough, not only to gain the programmatic benefits of synthetic fuels technology, but also long enough so that it would earn enough money to pay back its own debt—and that's the critical difference.

Mr. SYNAR. Let me see if I have got this straight. The operating procedure down at Synfuels is to negotiate for price supports in order to pay down debt. Are you saying you don't like that procedure?

Mr. CORCORAN. I am saying that that proposal was in effect turned down yesterday.

Mr. SYNAR. On this project?

Mr. CORCORAN. On this project.

Mr. SYNAR. OK.

Mr. NOBLE. It was not turned down. We didn't have the four votes that were necessary.

Mr. SYNAR. What did happen?

Mr. NOBLE. I guess it is just like over here in Congress, sir, where you have to have a majority, we have to have to have four-fifths. Sometimes you win some and sometimes you lose. We thought that the proposal, the suggestion, that the administration and DOE made, the only way that you can really assure this long term is to restructure the debt. We did agree on that. As I say, I still stand behind the staff-negotiated agreement.

Mr. SYNAR. Let me just ask you, are you going to accept DOE's proposal or are you going to renegotiate, start again?

Mr. **Noble**. I think we will try to renegotiate the debt.

Mr. **Synar**. Mr. Armey, for 5 minutes?

Mr. **Noble**. There is no DOE proposal at this point.

Mr. **Synar**. I'm sorry, the SFC proposal.

Mr. **Armey**. I hope you gentlemen will be patient with me. This is the first time I have ever held elected office and I never cease to be amazed at the types of activities which our Government is engaged in. Your comment regarding having to have four-fifths prompted me to observe that somebody had a four-fifths majority before they started this project. [Laughter.]

Mr. **Noble**. Or they didn't have one-fifth, let me put it that way.

Mr. **Armey**. I would like to get a handle on how and why this project was started. I think I understand. Sometime in the early 1970's, we became concerned that the energy crisis was real and permanent. You might correct me, if you will.

Mr. **Corcoran**. 1973.

Mr. **Armey**. 1973, the first time it was real—the energy crisis, that is.

Was the Synfuels Corporation authorized by the Congress? Where did it come from?

Mr. **Corcoran**. Department of Energy.

Mr. **Armey**. The Department of Energy created the Synthetic Fuels Corporation?

Mr. **Corcoran**. No, Congress created the Synfuels Corporation. The initial involvement of the Government in this project was with the Department of Energy.

Mr. **Armey**. OK.

Mr. **Synar**. Let me see if I can explain something. Here's what happened. We were in the process of creating a Synthetic Fuels Corporation. But until the Corporation could get operational, DOE was given the power to begin projects as Great Plains. I would beg to differ with Mr. Noble's earlier statement that this is a DOE project. This is not a DOE project. This is a synfuels project.

Mr. **Noble**. Sir, that is not correct.

Mr. **Synar**. This project happened because of the Energy Security Act, if you will read the legislation.

Mr. **Noble**. No; they were specifically not allowed to take this project.

Mr. **Armey**. Well, let's leave it that the Government created the project, and that I was taught never to trust anybody who says I am from the Government and I am here to help you.

Mr. **Noble**. Stay that way.

Mr. **Armey**. It was decided that we needed to spend $1.5 billion of the American taxpayers' money to build a coal gasification plant in North Dakota. Right?

Mr. **Noble**. They authorized a loan guarantee of a little over $2 billion, sir.

Mr. **Armey**. Who first came up with this idea? I sort of make rather broad distinctions—there's private business and then there's government.

Mr. **Noble**. As Congressman Synar said, when the legislation was set up, Congress appropriated $20 billion, sir. They put roughly $5 billion at the DOE for what they called a fast track program, because we weren't at that time in business, and this started under

President Carter. They instructed the DOE to start negotiating to develop synthetic fuel projects prior to the time that SFC was in what they call an "operational status."

Mr. **Armey**. OK.

Mr. **Noble**. There were three projects that were negotiated by the DOE before the Corporation became operational. One of those projects was the Great Plains Gasification Association, sir.

Mr. **Armey**. Again—and I hope you will allow me to be general about this—I am trying to understand whose idea this project was. Was it someone employed in the private sector of the American economy, or in the public sector of the American diseconomy.

Mr. **Noble**. It was a private sector idea, yes.

Mr. **Armey**. It was a private sector idea——

Mr. **Noble**. Yes, sir.

Mr. **Armey** [continuing]. To build this plant. They came to the Government and they said, we could build this plant if we had special consideration from the Federal Government?

Mr. **Noble**. Under the law that was in place, they applied to DOE, as I understand it, sir. I was not here when they made that application, but I understand that's correct.

Mr. **Armey**. OK.

I am an economist, and the first thing economists looks at is what resources are being used. One of the things you can do with resources other than use them is save them. Mother Nature took billions of years to build these precious coal fields which were saved for a long time, and might have been saved for a little longer had it not been for Federal involvement.

It seems to me that somebody, perhaps in the panic of a real oil crisis, decided that we ought to create a Synfuels Corporation and engage in this particular project. And with a combination of Government incentives and private initiatives, all of a sudden we have this enormous plant which has proven, as Mr. Corcoran you said, "to be a technological success, but a financial disaster."

Now, what I see is this enormous plant which needs a package or an arrangement that involves $820 million in price supports or we may have to shut this operation down and walk away from it.

One of the things that I am anxious to learn about, since I am now part of the decisionmaking process, is how in the world can decisions like this that get us in this kind of shape get made? One of the things that Mr. Corcoran said triggered something in my mind—at least the way he expressed it implied the responsibility is with the corporate partners. I am not sure that I would agree that the responsibility rests solely with them. It seems to me they at least were subjected to some Government inducement to go on this, as it were, wild goose chase.

Mr. **Noble**. I agree with you, sir.

Mr. **Synar**. Dick, we are going to do another round of questions.

Mr. **Armey**. OK.

Mr. **Noble**. I welcome the chance to visit with you, sir, because initially I did not think we should have a synthetic fuels program. I have changed my thinking on that to a very limited degree and I would like to visit with you privately and personally on the matter because I think it is a national security interest.

Mr. **Armey**. Thank you.

Mr. **Synar**. Thank you, Dick.

Mr. **Corcoran**. Mr. Chairman?

Mr. **Synar**. Yes?

Mr. **Corcoran**. In order that the record be clear, I wonder if I might respond just for a moment to what was said.

Mr. **Synar**. If it will be brief.

Mr. **Corcoran**. I will be very brief.

Mr. Chairman, and to our friend from Texas, let me say that the responsibility, in my judgment, does rest with the sponsors of this project. They started the project. As you probably know, in the gas pipeline business, they did, of course, work with the appropriate regulatory agencies of Government in order to get the kind of price which at that time appeared to make the project feasible from their standpoint.

I don't think that the Synthetic Fuels Corporation induced them back in 1973 to start this project. I don't think that the Department of Energy back at that time induced them to begin this project. It was developed, in fairness to them, in a very understandable way. They were looking for more supply. They wanted assured supply. They were concerned in the early 1970's because, I would submit, of erroneous, ill-advised Government regulations that the only way they could provide for the 20-year supply that was the tradition with the Natural Gas Policy Act at that time—and to some extent still is, although it is changing—that they needed to go ahead with this kind of project. So, they did it on their own, and they have to be held responsible.

Mr. **Synar**. Thank you, Tom.

Mr. Noble, I would like to focus on the rationale for providing the $820 million which, in your testimony, you indicate you support, in assistance to this project. As I mentioned in my opening remarks, it is very difficult to understand why the taxpayers should pump more money into a project which is now generally recognized as an economic disaster.

I realize that the decision was made back in 1982, as we have discussed in the last couple of minutes, and that decision was to underwrite the construction of Great Plains. And as bad a decision as it now appears to have been, it is a decision which, very frankly, is behind us. Now we have to cope with what I think is this enormously expensive problem, and I want to focus on how expensive this problem really is.

If the Government denies the sponsors more taxpayer assistance, they would probably abandon the project, the Federal loans would not be repaid, and the Government could recover certain tax benefits from the sponsors which they have enjoyed.

The result, according to your estimates, would be a loss to the Government of roughly $1.1 billion. Is that correct?

Mr. **Noble**. That is approximately correct.

Mr. **Synar**. Now, if we provide the project with $820 million, you believe that the project will continue to operate through the year 2009. Now, under this assumption you estimate that the cost of this project to the taxpayer will be $773 million. Is that correct?

Mr. **Groelinger**. If I might, that is approximately correct. I caution approximately, if the time is appropriate, I will have somewhat revised——

Mr. SYNAR. Let's say three-quarters of $1 billion.

Mr. GROELINGER. That is approximately correct, yes, sir.

Mr. SYNAR. OK.

Now, I understand that the sponsors' outlook for energy prices is quite different than the SFC's. If prices continue as the sponsors believe they will, it is doubtful that the project will continue beyond the life of any additional subsidy. In fact, they have made that point quite clear.

I would like to insert in the record at this time exhibit 1, which is a March 1, 1985, letter from Mr. Rackley of the Great Plains Gasification Associates to the Department of Energy.

[The letter follows:]

Great Plains Gasification Associates
600 Renaissance Center, Suite 1100
Detroit, Michigan 48243 (313) 259-4555

March 1, 1985

[illegible]
AAC'D
AM.P.A.
PROCESSED BY Cmw

Manager
Chicago Operations Office
U.S. Department of Energy
9800 South Cass Avenue
Argonne, Illinois 60439

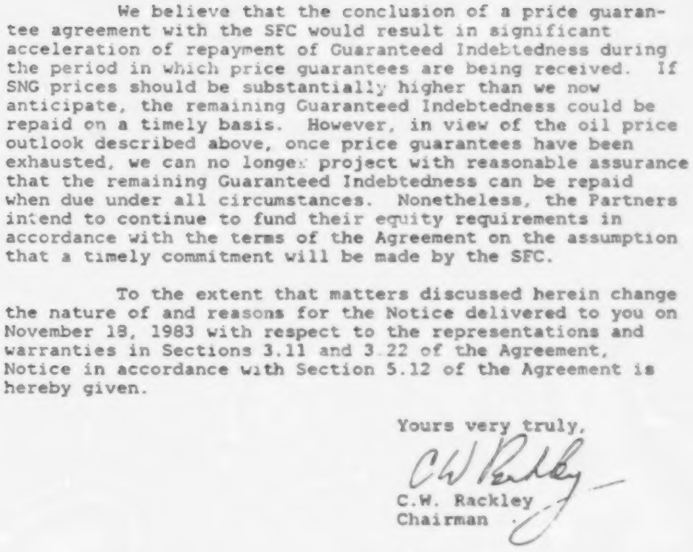
Re: Contract No. DE-FM01-82FE55014

Dear Sir:

Unless otherwise defined herein, the terms used and capitalized in the following shall have the meanings set forth in the Loan Guarantee Agreement dated as of January 29, 1982, as amended (the "Agreement"), between Great Plains Gasification Associates and the United States of America, acting by and through the Secretary of Energy (the "Secretary").

On November 18, 1983, we advised your office that because there had been no concrete assurances that the United States Synthetic Fuels Corporation ("SFC") would enter into negotiations for price guarantees or was otherwise prepared to provide a reasonable level of assistance to the Project on a timely basis, a determination had been made by the Partners to consider seriously termination of participation in the Project. Simultaneously, Notice pursuant to Section 5.12 of the Agreement was given to advise you that the representations and warranties in Section 3.11 and subsections (A) and (B) of Section 3.22(ii) could no longer be given.

Since the above referenced Notice, negotiations have proceeded with the SFC on a basis which allows us to conclude with a reasonable degree of confidence that support for the Project will be forthcoming in the relatively near future. The level of support contemplated is based upon an April 1984 Letter of Intent among the sponsors and the SFC. Since April 1984, the outlook for prices applicable to Great Plains' SNG has deteriorated substantially with declining oil prices. The existing excess of world oil production capacity that has caused the recent drops in current prices also portends several years of substantially lower prices than those projected at the time of execution of the Letter of Intent.



We believe that the conclusion of a price guarantee agreement with the SFC would result in significant acceleration of repayment of Guaranteed Indebtedness during the period in which price guarantees are being received. If SNG prices should be substantially higher than we now anticipate, the remaining Guaranteed Indebtedness could be repaid on a timely basis. However, in view of the oil price outlook described above, once price guarantees have been exhausted, we can no longer project with reasonable assurance that the remaining Guaranteed Indebtedness can be repaid when due under all circumstances. Nonetheless, the Partners intend to continue to fund their equity requirements in accordance with the terms of the Agreement on the assumption that a timely commitment will be made by the SFC.

To the extent that matters discussed herein change the nature of and reasons for the Notice delivered to you on November 18, 1983 with respect to the representations and warranties in Sections 3.11 and 3.22 of the Agreement, Notice in accordance with Section 5.12 of the Agreement is hereby given.

Yours very truly,

C.W. Rackley
Chairman

Mr. SYNAR. It refers to the previous $790 million SFC proposal, and explains that existing excess world oil production capacity and the continued decline in energy prices make full repayment of the debt doubtful.

Mr. Rackley says, "Once price guarantees have been exhausted, we can no longer project with reasonable assurance that the remaining guaranteed indebtedness can be repaid when due under all circumstances."

Now, Mr. Noble, if the sponsors don't think they can make money once the SFC subsidies expire——

Mr. NOBLE. They said under all circumstances, sir. I think that is a pretty broad statement.

Mr. SYNAR. OK, let me finish.

If the sponsors don't think they can make money once SFC subsidies expire, do they have a contractual right to abandon the project?

Mr. NOBLE. They have certain periods that they can abandon the project, some with more penalty than others.

Jim, do you want to go through that and give it a whirl?

Mr. SYNAR. I think the staff has researched this.

Until 1988, there are restraints on abandonment, but after 1988, it is based upon "a prudent business decision." Correct?

Mr. NOBLE. That's correct.

Mr. SYNAR. Is there any doubt in your mind that unless the sponsors——

Mr. NOBLE. Incidentally, they have that right to abandon on a prudent business decision right this minute without—it's tightened considerably in this agreement, very considerably.

Mr. **Synar**. Is there any doubt in your mind that unless the sponsors radically alter their view of future energy prices, they will abandon when SFC money is used up?

Mr. **Noble**. No, Congressman, energy prices are something that no one has really accurately predicted. When this was being negotiated by the DOE, I pointed that out and suggested then that it would be appropriate to make price guarantees because even—and this was in 1981, and I don't think anybody projected that the energy prices would drop as much as they did. But I did suggest very strongly that the appropriate way was not to guess at 10 years of price projections, first on oil and then on gas.

You have to understand or at least recognize that when you are negotiating it is to their advantage to project fairly low prices. We do not project our own prices. We do a compilation of the leading industries that do project prices and that's what we take an average on.

Mr. **Synar**. Ed, I understand that. The question was about abandonment.

Let me ask Tom: under the current projections of the sponsors, what do you think? Will they stay in after the SFC subsidies run out?

Mr. **Corcoran**. No, Mr. Chairman, I think they would abandon.

Mr. **Noble**. If their projections are correct.

Mr. **Corcoran**. I think that one of the things that we are looking for would be much greater assurance that they would stay in operation as a condition for any additional price supports.

Mr. **Synar**. Thank you, Tom.

Ed, have you seen the Department of Energy's most recent price projections?

Mr. **Noble**. No, but I think Mr. Groelinger has. I believe under their projections, though, it would be less chance of abandonment; is that correct?

Mr. **Groelinger**. We have reviewed the most recent EIA projections that were published in January 1985. We have not been privy to what I understand is in effect NEPP 5, which is not yet published.

Mr. **Synar**. You haven't seen them?

Mr. **Groelinger**. NEPP 5 has not been released to us.

Mr. **Synar**. OK.

Mr. **Groelinger**. With respect to the EIA prices that were published in January of this year, in general, our prices on the low, medium, high are lower than the EIA's low, medians, and highs.

While we are touching on this, if I might, the point was made earlier that apparently in the GAO analysis that our prices are lower than those used by DOE in the early years, and then the tracks switch. It was also pointed out that the analysis that GAO reviewed that were performed by DOE were done on a nondiscounted basis. I think the effect of doing that is to greatly diminish the reality of the situation where the conservative approach that we attempt to use is particularly important because it is in the early years. The early years are really those which drive what should or should not be done with respect to this project.

Mr. **Synar**. Mr. Noble, unless SFC's optimistic price outlook prevails, the sponsors will probably abandon the project around 1990.

You have estimated that the cost to the Government at that time, taking into account all tax considerations, will be about $1.1 billion. Is that correct?

Mr. NOBLE. The only thing I would correct is that I think our estimates are not necessarily optimistic, only the future will tell—but I think our estimates are relatively conservative.

Mr. SYNAR. Let me see if I have got this straight.

Mr. NOBLE. They are not as conservative as the sponsors but they are—in the 20 entities that we monitor, we are fairly conservative in our estimate.

Mr. SYNAR. Let me see if I can summarize here. If we don't give them the $820 million, it will cost us $1.1 billion. If we do give them the $820 million and they abandon in 1990, it will cost us $1.1 billion. So either way, the taxpayer eats over $1 billion.

Mr. NOBLE. But don't lose sight of the fact, sir, that the point of this exercise is to put a learning experience in front of us so that we can let the rest of the world know that we can utilize our massive reserves in case of interruption of supply or drying up of the glut.

Mr. SYNAR. That is one of the most expensive lessons in the history of our Government.

Mr. NOBLE. It may be very expensive otherwise.

Mr. SYNAR. So under either proposal, even under the most rosy of scenarios, this project will cost the taxpayers three-quarters of a billion dollars.

It makes me wonder why people think I am crazy about getting Government out of their business; because from that chart, and from those statements you have just made, the taxpayers are in for another billion dollars.

Mr. Clinger?

Mr. NOBLE. Mr. Chairman, if we have no energy shortage in the next 10 years, you will be absolutely correct. If we do, we will greatly need this ability to use our massive resources here, both as a leverage to keep prices down in this country, and as maybe a substitute for the Rapid Deployment Force.

Mr. SYNAR. Without getting into any debate, that's why we have a strategic petroleum reserve that the administation——

Mr. NOBLE. SPR is a short-term solution. This is a long-term solution.

Mr. GROELINGER. One other point, if I might, and that is that the basis for the three-quarters of a billion dollar number is, in our opinion, far from the most rosy scenario.

Mr. CLINGER. That is what I wanted to follow up on. You are saying that the assumptions including the price assumptions, including that you made are not overly optimistic, in your view, and would be somewhat less or more conservative than some of the other projections.

Mr. GROELINGER. That is absolutely the case. Our price assumptions are based, as Chairman Noble indicated, on a compilation of more than 20 independent and independently credible sources. So that we are not needing to be in a position of having to create forecasts and have them either be optimistic or conservative. We take from the existing body of forecasts regarded by both national oil companies and national agencies, banks, independent consulting firms, independent private firms—we take a panoply of these and consolidate them in a mathematical approach. So that we have a scenario that is based on a consensus view, and that forces the results not to be either conservative in any extraordinary fashion or optimistic.

Mr. CLINGER. As compared with the sponsors' projections which, because of business considerations, would necessarily be much less optimistic, looking at the worse case scenario.

Mr. GROELINGER. That is correct.

Mr. CLINGER. Mr. Corcoran, just following up on our earlier discussion and your mention of the idea of a task force to study alternatives to the proposed negotiations that have gone on, do you have any feeling of a timetable for how long this study might take? And, also, how would you assess the impact that the implementation of this proposal would have on the sponsors' decision whether to abandon or not abandon?

Mr. CORCORAN. Congressman, one of the things that we did yesterday was to authorize our Chairman to send a letter to the Secretary of Energy indicating our acceptance of the recommendations of the administration with respect to price supports and a longer time of operation of the project.

In that particular letter we indicated that we were prepared to work with the interagency task force to maintain a high level of negotiating activity. We talked in terms of daily contact and resolving this matter in a few weeks, if possible.

The point is, Congressman, that this issue has been around for a long time as was developed earlier in the discussion. There has been a great deal—and I understand it's 17 months of negotiation between the project sponsors and the management of the Synthetic Fuels Corporation. So the analyses have been done. We did request independent analyses of other agencies of Government at an earlier Board meeting. Those are not completed yet but they were sufficiently complete so that the letter, which I mentioned a moment ago, from the Energy Secretary, was provided.

Let me respond just for a moment also about the situation with respect to the sponsors. While I maintain they should be held responsible for the debt that they incurred and that the Department of Energy guaranteed, the fact of the matter is that this is a partnership program, particularly when you involve the Synthetic Fuels Corporation. To make the program work, it has got to be a private sector combination with the Government. I believe that the sponsors will not abandon as a result of what occurred yesterday. I do, as you know, think that the price support agreement that was proffered to us probably would have resulted in an abandonment sometime before 1990.

In this instance, however, I think we have to recall what the sponsors have said, and that is, they have made it very clear that they are looking for an assured source of supply. They have made it very clear that they want the kind of operating experience that you would get to demonstrate not only this particular gasifier but the balance of plants as well. The consortium involved in this project consists of a number of companies that are not new to Washington. They are not new to Government coordination and regulation.

I think that they will want to continue to work with us because, as is pointed out, the effect of the tax recapture provisions would be of some considerable consequence to them.

Finally, I think they have indicated before that they believe, as we believe, that it is in the national interest to get some extended operating experience with this kind of private project operating in the private sector of our economy. As a matter of fact, we even informally met with the chairman of the negotiating committee for the sponsors and assured them of our commitment and of our desire to work with him and other agencies of Government to bring this to a sensible solution.

Mr. CLINGER. Let me just summarize what seems to be emerging here.

In earlier discussion, Mr. Noble, you indicated that based on SFC projections, from the Federal Government's point of view we would be as well off, or as bad off, I guess, under either scenario—either abandonment now or abandonment down the road after the price supports had failed. In other words, the financial cost to the Federal Government would be roughly the same under either projection. But the additional loss to the Government and to the sponsors, in the event of abandonment now, would be that we would lose the opportunity to have those kinds of technological developments that I think both we and the sponsors are looking for. We know that there are problems still to be resolved in connection with this project which would go unresolved if we saw an abandonment at this point. We would lose all that additional knowledge, would we not?

Mr. NOBLE. We would lose the learning curve and experience that can really only come with the operation of these plants and the development of the cadre of people that might be needed sometime in the future to expand synthetic fuels when the marketplace demanded that we do so. That's the whole purpose of having the SFC here, so that you have not massive production. I don't think that people realize the scale-up risks involved. DOE, for instance, has spent billions of dollars in very fine R&D pilot plants, demonstration plants. But the thing that really is not very well understood is that when you increase the size of a plant, say, 10 times or 100 times, to bring it up to commercial scale, even though the technology works beautifully in that demonstration plant, there may be a lot of things that don't work in that scale-up, particularly when you are handling solids. It is what folks call dynamics of solids handling, that we really have to get a handle on, plus the environmental technology.

I know the chairman is very interested in environmental questions, and I am, too. I think that it is absolutely essential that this country have a few plants out there where we get this environmental technology perfected when we don't have a crisis. Some of the technology has been run overseas on a commercial scale in this plant that we are building. But we don't have the environmental technology perfected that we would like to see before we have to build 20 or 30 or 40 of these plants.

These are the kinds of things that you really need to develop now when you don't have a crisis. It truly is not economic at this moment, as Congressman Armey, who is an economist knows. We don't need synthetic fuels today other than for a national security reason to perfect this technology when we could use these massive resources in the future.

Mr. **Synar**. The gentleman's time has expired.

Mr. Armey?

Mr. **Armey**. As I mentioned before, I am more interested in the allocation of resources here than I am dollars; Congress proves every year that it can produce as many dollars as it wants.

I see we have spent Federal dollars to the tune of about $1.46 billion. That was a combination, it appears to me, of hasty incentives and hasty encouragement by Government, and business making decisions on the basis of the information coming from that.

We face now at least the possibility that the partners might abandon the project. I understand that if they were to abandon it the market value of the facility, it would be something in the neighborhood of $300 million. Is that correct?

Mr. **Noble**. I don't know. I don't know what anybody would pay for the plant at this point. I would guess it would be a very low amount of the invested price.

Mr. **Armey**. I assume, then, if it were abandoned by the partners it would become the property of the U.S. Government—DOE, I suppose, right?

Mr. **Groelinger**. Eventually.

Mr. **Armey**. It would be an interesting problem, sort of like somebody dropping a white elephant in your backyard, wouldn't it?

Would it be logical, since we do have the technological knowledge embodied in the plant and the technological capability, to mothball the plant? Has anybody done an estimate of what it would cost to mothball it?

Mr. **Noble**. I have the vice president of technology here, but my understanding is it would be an almost an impossible task to mothball that plant up there with all the piping and so forth.

Mr. **Armey**. All the what?

Mr. **Noble**. The piping and so forth.

Maybe there's someone here from the Great Plains that would want to comment on that but I understand it would be very difficult and maybe impossible to mothball that plant in North Dakota. I really don't know the technical involvement but I know it would be very difficult. There are thousands of miles of pipe.

Mr. **Armey**. We have so much emphasis on budget freezes around here, this could be a logical possibility.

Mr. **Noble**. Mr. Rackley is here, he might answer that when he testifies.

Mr. **Armey**. All right, I will say that because that is a possibility.

Mr. Corcoran, I think you indicated that it might be possible to negotiate an arrangement other than the $820 million where it would be in the mutual interest of the American people and the partners to continue production. Whether we spend $820 million or some smaller amount; whether we do it by this price support arrangement or some other; let me remind you of the harm that could be done by price supports; I am not a fan of them in any regard.

What would we possibly get for either the $820 million or any renegotiated amount? Would it be possible to get cheaper gas or would we get some technological gain in knowledge as you indicated? Is there any possibility that we could make a deal that would be worth the price tag we would have to put on it?

Mr. **Corcoran**. Congressman, that is, of course, the critical option to evaluate at this point. Based on the information that I have at this point, I think the answer to your question is in the affirmative.

I believe that we can, with some reliability, predict what the operating costs of that facility would be over time. Although I am not an economist, I suspect if you knew what the income stream would be, you could figure out the value of the asset. Therefore, what we have proposed is that the responsible agency of Government, in this instance, the Department of Energy, work with the sponsors and work with the Federal Finance Bank—which has provided the money in this instance—which is a component of the Department of Treasury. This is not the typical loan guarantee, for example, that I am sure you have encountered already in your short tenure in Congress whereby somebody wants some assistance from the Small Business Administration, and goes to the local bank to get the money but with a guarantee from the Government.

This is different. This is one where the Federal Finance Bank, an agency of the Government, has provided the $1.5 billion which have been drawn down against the $2.02 billion loan guarantee.

So, I think based on the numbers, based on the commitment that I believe the sponsors, and the Government, has to this project, that we could work out a reasonable deal for everybody involved. I think the benefit of that would be, as has been pointed out, that we would get the operating experience.

I think it should be emphasized that this is a rather unique technology. This is quite different, in a sense, from many of the other technologies that are being considered by the Synthetic Fuels Corporation. This is not an unproven technology. It is proved. They have been using it for years and years—in an earlier version during World War II by the Germans, and in an improved version by the South Africans. So this is a different situation.

Nonetheless, we want it to operate because we do think you are going to get operating experience, you are going to get maintenance experience out of it. You are not going to get a lot of synthetic fuel benefits out of it, as you would based on the Rand Corp. evaluation of what innovative technologies, pioneer, first-of-a-kind project plants would give you. So you don't get the reductions in future follow-on plants. But you do get operating experience.

But most importantly, what you get under the proposal which I think the SFC Board would like to see developed by the Department of Energy with the sponsors, is a continuation of operation so that enough money would be generated so that they could pay back their debt. So you get the knowledge, plus you get them paying back their debt.

Mr. **Noble**. In addition to the plant that he mentioned, there is a first, I believe, methanation process, commercial scale, in this plant, as well as the environmental technology with which they did a fairly good job, I think, on the water effluents and the air effluents. This is a much improved environmental technology which needs to be developed when we don't have a crisis.

Another thing about the agreement—and I don't know how familiar you are with it—that it is unlike the average price guarantee. There is a reasonable chance that this money can come back. We do have recoupment provisions. In fact, before the price guarantee is made, or as it is being made, in the first 3 years the sponsors put in themselves another $190 million of their cash plus all their tax benefits. Then they are later able to recover that $190 million but then they have to pay 90 percent of the net cash-flow to the taxpayers until the debt is repaid to DOE. They receive 10 percent even after it is totally paid off. The taxpayers receive 75 percent of the net cash-flow, which is a little different than the average price guarantee that we think of in the Federal Government.

Mr. **Synar**. The gentleman's time has expired.

Mr. **Armey**. Thank you.

Mr. **Synar**. Mr. DeLay?

Mr. **DeLay**. Thank you, Mr. Chairman.

I have no questions at this time, but would like to apologize for being late. My responsibilities on the Public Works and Transportation Committee required that I attend the scheduled markup. I ask unanimous consent to enter my opening remarks for the record.

Mr. **Synar**. Without objection.

Mr. **DeLay**. Thank you.

[The opening statement of Mr. DeLay follows:]

OPENING STATEMENT OF HON. THOMAS D. (TOM) DELAY

Mr. Chairman, I want to thank you for the opportunity to hear the testimonies of these gentlemen here today. I particularly want to thank all of the witnesses for taking the time, and making the effort, to present their perspectives on the topic of Federal assistance to the Great Plains coal gasification project in North Dakota.

Unfortunately, the option of price guarantees for the sale of Great Plains' synthetic fuel is not inherently appealing to many of us. Neither, however, is the philosophy that brought the Government into the business of synthetic fuel production in the first place. Although I adamantly oppose such Government intrusion in the market-place. We are not here today to debate what is now history. The fact of the matter is that we now must deal with the consequences of this mistake.

Mr. Chairman, I look forward to hearing the testimonies of these witnesses so that this committee can take steps to best address the problem before us.

Mr. **Synar**. Thank you very much.

Staff, any questions?

Mr. **Young**. To clarify for the record, Mr. Groelinger, you questioned the validity of GAO's testimony earlier today about DOE's price projections. Have you seen DOE's NEPP 5 price projections?

Mr. **Groelinger**. We have not had released to us DOE's NEPP 5.

Mr. **Young**. So you really don't know whether, in fact, DOE's price projections, the most recent NEPP 5, are higher or lower than the SFC's?

Mr. **Groelinger**. There has been some discussion amongst staff. We have not had NEPP 5 released to us. As I indicated earlier, we have compared our projections with the most recent EIA projections that were published in January 1985, and we are lower in comparable cases than the EIA cases.

I understand that on the NEPP 5 they are more in line but I do not know an exact correlation between ours and NEPP 5.

Mr. **Synar**. Thank you.

Mr. Noble, it appears that the taxpayer is going to lose about three-quarters of a billion dollars on this project. Let's look at why the Government should disregard Mr. Thomas' advice. As I mentioned in my opening statement, again, that advice was that sunk costs are sunk——

Mr. **Noble**. Regard whose advice, sir?

Mr. **Synar**. Mr. Thomas.

I quoted him in my opening statement that sunk costs are sunk costs, and you shouldn't throw good money after bad. It only makes a bad situation worse.

Under the SFC proposal, you estimate that the entire $820 million will be spent over the next 5 or 6 years. Isn't that correct?

Mr. **Noble**. Yes, sir.

Mr. **Synar**. OK. And over that same period of time you estimate that the sponsors will have repaid the Government about $600 to $700 million of outstanding debt; is that correct?

Mr. **Groelinger**. I believe on our scenario it is somewhat more than that.

Mr. **Synar**. How much?

Mr. **Groelinger**. Approximately $800 million would be repaid in the SFC median scenario.

Mr. **Synar**. In simple terms, the Federal price supports will be used to pay back the Federal debt. So let's focus on how the sponsors are going to use the $820 million between the time it leaves the Treasury as price supports, and the time it is returned to Treasury as debt repayment.

GAO testified that without any additional subsidies the project would experience positive cumulative after-tax cash-flows over the next 5 to 6 years due to the substantial tax benefits available to the parent companies.

SFC's analysis confirms this to be true; isn't that correct?

Mr. **Groelinger**. That is correct.

Mr. **Synar**. Now, GAO has testified that the sponsors are concerned about their book losses more than they are about project cash-flows during that time period. Book losses would depress their stock values and bring trouble on Wall Street. Between the time Treasury outlays money for price supports and receives money back as debt repayment, the sponsors record the $820 million as operating income. And by running the $820 million through their books as operating income, the sponsors avoid sizable book losses that they fear would depress their stock values. Is that not true, Tom?

Mr. **Corcoran**. Mr. Chairman, that is a matter of concern. That is one of the reasons why I have requested an independent analysis of the proposed price agreement.

Mr. **Synar**. So, in large part, the $820 million is designed to clean up the books of Tenneco, American Natural Resources, and the others, and to keep Wall Street happy.

The other purpose of the $820 million, obviously, is to secure the $600 to $700 million, or as you say, $800 million, of DOE debt.

Now, Tom, you were in Congress when we passed the Energy Security Act. Was it your understanding that Congress created the SFC to protect the stock values of companies like these and to bail out bad debt previously issued by DOE?

Mr. **Corcoran**. No, Mr. Chairman, it certainly was not. I think that we would have to await the evaluations of these independent analyses before I could draw any conclusion.

Mr. **Noble**. Let me say, sir, we have no intention to try to schedule these to clean up somebody's books. The purpose of the Energy Security Act and I think what we are charged under law to do is to give the country some energy security by having these plants, these first-of-a-kind plants that give us this learning curve that can give the country some security for the future. This deal is not a corporate welfare deal.

Mr. **Synar**. I know that is what you are concerned about, but from everything we have seen from the companies, that is not what they are concerned about. They are concerned about the stock value.

Mr. **Noble**. Our concern is the same as yours: this country. We are not concerned about the corporations' books, and this is not a welfare deal for those corporations. This is probably the toughest negotiated contract that I have seen, and maybe you have seen some tougher ones, but as a workout deal, as a banker would look at it, this is a tough deal. When they have no interest in it, they get 10 percent, and this is after they put $190 million in. After they own it totally they only get 25 percent of the cash-flow. So, this is a tough deal.

Mr. **Groelinger**. I might add, the purpose of the deal is not to clean up their books, and it is not to repay the debt. The purpose of the deal was oriented to getting the plant to operate. This is a negotiated transaction and it only can be concluded when all parties are willing to accept it. The parties have various motivating factors and all of those have to be dealt with to some greater or less degree. But the purpose of the deal is to have the plant operate. It achieves other things that are important to the parties, and that's the way a negotiated deal comes to a settlement.

Mr. **Synar**. OK.

Mr. Noble, on February 1 of this year, I wrote you expressing concern over the SFC's legal ability to take action on Great Plains. At this time, I would like to enter that letter into the record as exhibit 2.

[The letter follows:]

NINETY - NINTH CONGRESS
Congress of the United States
House of Representatives
ENVIRONMENT, ENERGY, AND NATURAL RESOURCES
SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-371-B-C
WASHINGTON, D.C. 20515

February 1, 1985

Honorable Edward E. Noble
Chairman
U.S. Synthetic Fuels Corporation
2121 K Street, N.W.
Washington, D.C. 20586

Dear ~~Mr. Chairman~~: Ed

Over the past three years, operations at the Synthetic Fuels Corporation (SFC) have been hindered by repeated allegations of improper or unethical conduct by SFC Board members. Indeed, conflicts of interest and the appearance of conflicts of interest amongst SFC directors have resulted in the resignations of 3 Board members and two SFC presidents. With the reinstatement of an operating quorum, the SFC Board is once again faced with several imminent decisions which will bear directly upon the Corporation's ability to conduct its business in a manner above suspicion. Based upon its disappointing track record in this respect, I urge the Board to resolve in an open and prompt manner several outstanding issues prior to taking any actions which could further jeopardize the program's credibility. I am specifically concerned about Board actions affecting the Great Plains Coal Gasification Project and the nomination of Mr. Norman Callner as President of the SFC.

At the SFC's December 1984, Board meeting, the Corporation's ethics officer, Mr. Owen Malone, notified the Board that two members, Messrs. MacAvoy and Reichl, maintain financial interests, as defined in Section 118(c)(1) of the Energy Security Act (ESA), in companies involved in the Great Plains Project. In the past, various financial interests of Board members have been reviewed and generally disregarded by the Board as that of being "too remote or too inconsequential to affect the integrity of such Director's services for the Corporation in that matter." These determinations have taken place immediately before Board actions on the particular matters, and have been based largely on the recommendations of Mr. Malone. While Mr. Malone has yet to make any recommendations to the Board with respect to Messrs. MacAvoy's and Reichl's financial interests in Great Plains, a review of these interests suggests they are neither "remote" nor "inconsequential."

Mr. MacAvoy presently serves as a director of Combustion Engineering, Inc., whose subsidiary, C. E. Lummus, has maintained a considerable responsibility in construction of the Great Plains Project. According to the project's engineering, procurement and construction services contract, "Lummus shall maintain the prime responsibility for the quality, scheduling and cost control for the work done" by contractors. While adequate scheduling and cost control have been demonstrated through on-time, under-budget construction of the project, the quality of work can only be proven through sustained plant operations -- plant operations which the project's sponsors claim are dependent upon SFC assistance. Business prospects for Lummus, and therefore Combustion Engineering, in the area of constructing synthetic fuels plants will likely be enhanced by any assistance the SFC provides to ensure the success and profitability of Great Plains. For his services on the Board of Combustion Engineering, Mr. MacAvoy has received $45,000 in director's fees over the last two years. In addition, as you know, Mr. MacAvoy maintains a stock interest in Combustion Engineering.

Mr. Reichl's spouse has stock holdings in two companies which have a combined 40% interest in Great Plains. Mrs. Reichl's holdings in these companies, according to the SFC's Office of Ethics, are presently valued at more than $76,000. While these holdings may represent a small portion of the Reichl's net worth, few people would view $76,000 as an "inconsequential" sum of money.

It is equally important to assess the likelihood that a Board action will in any manner affect the value of the director's financial interests in question. In the unique case of Great Plains, project construction has been completed and start-up operations are running at over 60% of plant capacity. Despite the benefits of over $1.5 billion in direct taxpayer loans and an above-market FERC-approved pricing formula, the Great Plains' sponsors have demanded further taxpayer subsidies to insure their continued participation in the project. The sponsors have publicly stated that projected book losses during the early years of plant operations could adversely affect the companies' earnings, negatively impact their credit ratings, and depress the value of their stock. Indeed, the SFC's proposed commitment of an additional $790 million in price supports for Great Plains is designed in large part to secure the continued participation in the project by the current sponsors by alleviating these concerns and protecting the sponsors' Wall Street image. The SFC's proposed price supports for Great Plains may also serve to protect the value of Mrs. Reichl's related Wall Street investments.

BEST COPY AVAILABLE

As provided in the ESA, any SFC action on Great Plains, will require four Board votes. Yet, two of the five directors maintain a financial interest in voting matters relating to the project. The ESA expressly forbids directors from participating in matters before the Corporation in which he/she has a financial interest unless "the Board of Directors determines by majority vote that the financial interest is too remote or too inconsequential to affect the integrity of such Director's services for the Corporation in that matter." The director involved can not participate in the Board's determination. Hence, a vote on Mr. MacAvoy's ability to participate in matters regarding Great Plains will require Mr. Reichl's participation. In turn, a vote on Mr. Reichl's ability to participate in matters regarding Great Plains will require Mr. MacAvoy's participation. In the end, SFC action on Great Plains' request for additional Federal assistance will require either Mr. MacAvoy's or Mr. Reichl's participation in a matter in which they each have a financial interest. Such participation clearly appears to be forbidden by the Act.

On May 16, 1984, this Subcommittee held a hearing to examine events surrounding Board actions at the SFC's April 26 meeting. As you are aware, the Subcommittee was concerned that the Board had consciously moved forward with some $3 billion in award decisions despite foreknowledge of information questioning the ethical conduct of one of its directors. It was of further concern that such information was disclosed publicly only after the Board had taken action. At the hearing, you testified that the Board weighed all legal and ethical considerations and determined to move forward with the day's business, despite the appearance of unethical conduct by one Board member, due largely to the responsibilities the Board holds to fulfilling the goals of the ESA and to the companies which have invested in projects seeking taxpayer subsidies. I maintained, and continue to maintain, that the Corporation's primary responsibility is to the public's trust and confidence in the decisions being made at SFC and in those making the decisions. The need to carry out SFC's mandated project responsibilities can in no way supercede specific prohibitions in the law. The Act is clear. In the absence of a qualified quorum the Board can not take action. With respect to Great Plains, such a qualified quorum does not appear to exist.

Accordingly, please advise me of the Board's intentions in dealing with this issue and provide the Subcommittee with all memoranda, briefs, recommendations, etc. provided to the Board by the SFC's legal counsel and/or ethics officer with respect to the Board's ability to act on Great Plains' request in light of the foregoing circumstances.

Honorable Edward E. Noble
Page Four
February 1, 1985

I am also concerned about the nomination of Mr. Norman Callner for the position of SFC president. As a vice-president of Houston National Gas, Inc., Mr. Callner was actively engaged in contract negotiations with the Corporation on behalf of two projects soliciting SFC assistance. One project, the North Alabama Project, remains in competition with other projects under the SFC's fourth general solicitation. As president, Mr. Callner would oversee the Corporation's day-to-day activities and holds ultimate responsibility for project recommendations made to the Board by the staff. Mr. Callner's participation in actions relating to the North Alabama Project, or other projects in direct competition for SFC funds with the North Alabama Project, could present the appearance of a conflict of interest, if not an actual conflict of interest. Please advise me as to how Mr. Callner could properly recuse himself from any such activities and continue to provide the Corporation with effective internal leadership.

The most important task before the Corporation at this time is that of regaining public confidence and credibility. Without these, the success of the program, as with any Federal program, is doomed. The manner in which the Board handles the Great Plains issue and Mr. Callner's nomination will go a long way toward determining whether such confidence and credibility can be restored.

I appreciate your attention to these important matters, and hope to receive your response by February 15, 1985.

Sincerely,
Mike
MIKE SYNAR
Chairman

MS/ry

Mr. SYNAR. In the letter, I pointed out that two of the five SFC Directors, Mr. Reichl and Mr. MacAvoy, hold financial interests in Great Plains.

I also pointed out that the Energy Security Act prohibits Directors from voting on any matter in which they hold a financial interest unless, by majority vote, the Board determines that such interest is too remote or too inconsequential to affect the integrity of the Director's participation.

I went on to point out that a majority vote as defined by the act requires four affirmative votes. Now, the Board has only five Directors. Therefore, a vote on the remoteness or inconsequence of these interests in Great Plains would require Mr. Reichl to vote on Mr. MacAvoy's interest and Mr. MacAvoy to vote on Mr. Reichl's interest. Such participation, I said in that letter, appears to be forbidden by the act.

Now, on February 27, you responded by letter that you were aware of these circumstances and that SFC would handle this conflict question as they had in the past. Your response will be inserted in the record at this time as exhibit 3.

[The letter follows:]

United States Synthetic Fuels Corporation
2121 K Street, N.W. Washington, District of Columbia 20586 Telephone (202) 822-6600

February 27, 1985

RECEIVED
FEB 27 1985
TIME ....
SUBCOMMITTEE ON ENVIRONMENT,
ENERGY & NATURAL RESOURCES

The Honorable Mike Synar
Chairman
Environment, Energy and Natural
Resources Subcommittee
House Government Operations Committee
Washington, D.C. 20515

Dear ~~Mr. Chairman:~~ Mike,

This acknowledges your letter of February 1, 1985 requesting advice concerning the intentions of the Corporation's Board of Directors respecting (1) certain financial interests of Board members Paul MacAvoy and Eric Reichl in companies which have interests in the Great Plains Gasification Associates Project, (2) whether Messrs. MacAvoy and Reichl may form part of the voting quorum required under Section 118(c)(3) of the Energy Security Act ("Act") to determine their respective qualification to vote on matters affecting Great Plains, and (3) the Corporation's consideration of Mr. Norman Callner for the position of president of the Corporation.

Your letter notes correctly that at the December 13, 1984 meeting of the Board of Directors the Corporation's ethics officer, Mr. Malone, made a report to the Board concerning certain financial interests of Messrs. MacAvoy and Reichl involving business corporations which have economic interests in the Great Plains project. The ethics officer's report was part of an established procedure under which the financial interests of the Corporation's directors are monitored to identify interests involving matters requiring action by the Board and which may pose conflict of interest problems under Section 118(c)(1) of the Act. The reports are based on the Executive Personnel Financial Disclosure Reports (SF 278) filed by the directors under the Ethics in Government Act, which are reviewed by the ethics officer before each meeting of the Board.

As noted in your letter, the financial interests relevant to Great Plains covered by the ethics officer's December report are Mr. MacAvoy's current position as a director of Combustion Engineering, Inc., and ownership of Combustion Engineering common stock, and Mr. and Mrs. Reichl's reported stock holdings in American Natural Resources Company ("ANR") and MidCon Corporation. As reported to the Board and noted in your letter, C.E. Lummus, Inc., a wholly-owned subsidiary of Combustion Engineering, Inc., has been one of the principal construction contractors on the Great Plains project, and -- pertinent to Mr. Reichl's interests -- ANR Gasification Properties Co., a wholly-owned subsidiary of American Natural Resources Company, and MCN Coal Gasification Company, a wholly-owned subsidiary of MidCon Corporation, each have an interest in Great Plains Coal Gasification Associates, the sponsor of the Great Plains project. While Messrs. MacAvoy and Reichl and the Board have been advised that these interests are financial interests within the purview of Section 118, the Great Plains project has not been scheduled for action by the Board, and there has been no further action regarding the financial interests in question.

In the past the Board of Directors has reviewed various financial interests of members of the Board, and as authorized under Section 118(c)(3) of the Act, has determined by resolution that particular interests have been too remote or too inconsequential to affect the integrity of the interested director's votes on particular matters which have come before the Board. This review is available with respect to any financial interest of a director if that director feels that the financial interest is too remote or too inconsequential to affect the integrity of his or her service for the Corporation in the particular matter with respect to which the interest is pertinent. After disclosure of the financial interest, and if a majority of the Board agrees that the interest is too remote or too inconsequential to affect the integrity of the director's vote, a resolution to that effect may be approved by the Board. Such a determination constitutes a waiver of the prohibition against voting contained in Section 118(c)(1).

It should be noted that the disclosure and waiver provisions of Section 118(c) establish a procedure for dealing with financial interests of the Corporation's directors which is comparable to that prescribed for dealing with financial interests of federal employees under Section 208 of title 18 of the United States Code. Under 18 U.S.C. 208(a), federal employees are prohibited from participating personally and substantially in matters of official business in which the individual, his or her spouse or children, or an organization he or she may be serving as an officer, director, or employee, knowingly has a financial interest. However, and as provided by 18 U.S.C. 208(b), this prohibition does not apply if the individual discloses the interest and receives a written determination by the official responsible for his or her appointment that the financial interest is not so substantial as to be deemed likely to affect the integrity of the services which the government may expect from the employee. Similarly, under Section 118(c)(3) of the Act the prohibition against a director voting when he or she has a financial interest in a matter before the Board may be waived if the Board is satisfied that the interest is too remote or too inconsequential to affect the integrity of the director's services.

The factors generally weighed under both Section 208(b) and Section 118(c)(3) in reaching this kind of determination, include, among any other relevant considerations, (1) the significance of the financial interest in terms of the overall financial position of the individual and his or her spouse, (2) whether the interest is in a small, closely held enterprise the fortunes of which could be affected by the official action in which the individual would participate but for the prohibition, (3) whether the interest involves a large publicly traded corporation, (4) whether the interest involves an enterprise having substantial interests and activities in matters under the cognizance or programmatic authority of the Corporation, (5) if the interest is held in trust, whether the trustee is an institutional trustee with exclusive management of the interest or whether the beneficiary has any control over the interest, (6) whether the individual's participation in the official matter is reasonably viewable as likely to have any direct or predictable affect on the financial interest involved, and (7) consideration, as well, of the public's interest in the director's being able to perform his or her official duties as a member of the Board.

Your letter notes correctly that in the past the Board's determinations concerning financial interests of the Corporation's directors have been made immediately before Board action on the particular matters to which the interests have been relevant. There are a number of reasons for this. The prohibition of Section 118(c)(1) applies to particular matters to be voted on by the Board of Directors. Consequently, until a project is scheduled for Board action there is no specific basis for any meaningful review of the directors' financial disclosure reports. Once a particular matter has been scheduled for action, the ethics officer is able to do an up-to-date review to identify the current participants in the project and any financial interests within the purview of Section 118(c)(1). Deferring the determination and the preparation of related recommendations regarding the remoteness and consequentiality of the identified financial interests until action is scheduled also takes account of the fact that the circumstances could change. For example, a director might elect to forego requesting a determination by the Board and recuse himself from voting or he might divest himself of the interest, or the firm in which the financial interest is held might withdraw from the project -- thus obviating the need for any recusal by the director or action under Section 118(c)(3). Similarly, the nature of the overall financial interests of the director might change, thus altering the evaluation made in determining whether the prohibition should be waived. The Corporation's procedure in this regard has been in place since early in 1982 and has resulted in a very diligent monitoring of financial interests and effective avoidance of any conflict of interest problems involving the financial interests of directors.

I note particularly the statement in your letter that your review of Messrs. MacAvoy's and Reichl's financial interests in Great Plains suggests that the reported interests are neither "remote" nor "inconsequential". I have also noted your discussion of the interests and have made copies of the letter available to all of the members of the Board so that they will have the benefit of your views. As the Act makes clear, and as noted above, the determination whether these financial interests are too remote or too inconsequential to be reasonably viewable as not likely to affect the integrity of Messrs. MacAvoy's and Reichl's votes on the Great Plains project is a decision reserved to the Board of Directors under Section 118(c)(3). Such a decision would require an independent judgment by each member of the Board, and I am not in a position to know beforehand the mind of each director. All of the considerations relevant to such a judgment will have to be weighed by each member of the Board in light of the facts at the time of the Board vote. I am confident that if they should be called upon to participate in such a determination, the members of the Board will carefully consider all of the factors germane to the determination and give every appropriate consideration to the assessment of the interests contained in your letter.

You also suggest that Mr. McAvoy, by reason of his interest, will be disqualified under Section 118(c)(1) from participating in any determination under Section 118(c)(3) as to the remoteness and consequentiality of Mr. Reichl's interest, and that Mr. Reichl will similarly be disqualified from participating in such a determination concerning Mr. McAvoy. Should Messrs. McAvoy and Reichl hold their interests at the time of a Board vote on Great Plains, and should either director request such a determination under Section 118(c), I have requested our counsel to review the matter and advise the Board of the appropriate application of Section 118(c) in light of the then existing facts and circumstances. I shall be pleased to inform you of the results of that review when made.

Your letter also expresses a concern regarding the Corporation's consideration of Mr. Norman Callner for the position of president of the Corporation. Mr. Callner, a former executive of Houston Natural Gas, Inc., participated in contract negotiations with the Corporation on behalf of the North Alabama Coal-to-Methanol project, whose application for assistance was until very recently pending before the Corporation under the Fourth General Solicitation. Your letter asks whether Mr. Callner could properly recuse himself from Corporation actions relating to the North Alabama project and other projects in direct competition with North Alabama for funding and still continue to provide effective leadership to the Corporation. The question whether Mr. Callner's service for the Corporation would pose any actual or apparent conflict of interest problems has received close attention. Neither Mr. Callner nor Houston Natural Gas, Inc. has any financial interest in the North Alabama project any of the other projects pending before the Corporation. I have been advised by our ethics officer that Callner's service would pose no problem under the conflict of interest laws applicable to the Corporation and that his recusal from official actions affecting matters in which he participated while employed in the private sector would be an appropriate and adequate arrangement for obviating any appearances of bias or partiality respecting the Corporation's decision-making processes.

Mr. Callner is a very experienced manager with excellent technical credentials and a great deal of knowledge and experience clearly pertinent to synthetic fuels development. There is, and has been, no question in my mind that Mr. Callner could recuse himself from involvement in actions affecting the North Alabama project without impairing his ability to manage and lead the Corporation.

Earlier this month the consortium sponsoring the North Alabama project, which no longer includes Houston Natural Gas, announced the withdrawal of the project from consideration under the Fourth General Solicitation, thus diminishing even further any concerns regarding Mr. Callner's effectiveness.

Finally, your letter requests that the Subcommittee be provided copies of all memoranda, briefs, and recommendations provided to the Board of Directors by legal counsel and/or the ethics officer respecting the Board's ability, in light of the matters discussed in your letter, to act on Great Plains' request for financial assistance. Please be advised that other than the material forwarded to the Subcommittee on January 4, 1985 in response to its request of December 17 [illegible] no such memoranda, briefs and recommendations have been provided to the Board.

I trust that this is helpful to you and the Subcommittee. If you have any additional questions, or if I can be of assistance in any other way, please let me know.

Sincerely,

Ed

Edward E. Noble
Chairman of the Board

Mr. SYNAR. In that letter you stated:

> The Corporation's procedure in this regard has been in place since early 1982 and has resulted in very diligent monitoring of financial interests and effective avoidance of any conflict-of-interest problems involving the financial interest of Directors.

Mr. Noble, my letter of February 1 was not intended to bring unknown information to the attention of the Board, but rather to urge the Corporation to deal with this conflict question in a prompt and forthright manner.

Now, quite frankly, the Corporation's track record with respect to conflicts of interest and the resignation of three Directors and two presidents, the loss of a quorum and the loss of a good deal of credibility, speaks for itself.

Mr. NOBLE. All of those Directors did not resign because of conflicts of interest, sir.

Mr. SYNAR. It does not reflect "effective avoidance of conflict-of-interest problems."

The purpose of my letter was to avoid the situation we are in today. But since it was not dealt with, I would like to address some of the questions to the Corporation's ethics officer, John Roberts. If he will come forward, I would like to ask him some questions.

Mr. Roberts, under the SFC's ethics policy, you are responsible for determining whether or not a Board Director holds a financial interest as defined by the Energy Security Act in a matter pending before the Board; isn't that correct?

Mr. ROBERTS. Yes, sir.

Mr. SYNAR. Mr. Reichl's financial disclosure statements indicate that his wife maintains stock holdings in MidCon Corp., a 15 percent partner in Great Plains.

On December 7, 1984, Mr. Reichl informed the former SFC ethics officer, Owen Malone, that his wife owned 1,333 shares of MidCon stock. Currently, such holding would represent about a $71,000 investment.

Is this an accurate reflection of Mr. Reichl's current interest in MidCon, Mr. Roberts?

Mr. ROBERTS. I don't believe that has changed.

Mr. SYNAR. In a February 5, 1985, Washington Post article, Mr. Reichl said of this interest in Great Plains, "It's inconsequential * * *. As a matter of principle I don't think I should have to sell it."

This article will be entered into the record at this time as exhibit 4.

[The article follows:]

WASHINGTON POST / February 5, 1985
Federal Report

Inside: the Synthetic Fuels Corp.

Conflict Queries Cloud Coal-Gas Plant's Fate

The fate of the Great Plains coal gasification plant, the country's most ambitious experiment in synthetic fuels production, is under a new cloud because of conflict-of-interest questions raised at the U.S. Synthetic Fuels Corp.

Two new members of the agency's board of directors, energy consultant **Eric H. Reichl** and economist **Paul W. MacAvoy**, have financial interests in companies involved in the Great Plains project, according to financial disclosure statements submitted to the corporation.

Agency ethics officer **Owen J. Malone** has warned the board that these interests may be significant enough to bar Reichl and MacAvoy from participating in any votes on the project.

The implications for Great Plains could be significant, according to agency and congressional sources. Last year, the corporate sponsors of the huge North Dakota project received a tentative "letter of intent" from the Synfuels Corp. for $700 million in new federal subsidies, funds they said were essential if the $2.1 billion plant was to stay in business.

But the Synfuels Corp. never got around to giving final approval to the Great Plains grant. The reason: The board lacked a quorum after agency president **Victor M. Thompson** resigned last April amid charges of ethical improprieties.

Now that the board has enough members once again, another thorny set of conflict questions has been raised. Reichl's wife owns stock worth about $76,000 in two companies—American Natural Resources Co. and the Midcon Corp.—that are among the five principals in the Great Plains consortium.

MacAvoy, who was a member of President Gerald R. Ford's **Council of Economic Advisers**, sits on the board of Combustion Engineering Inc., whose subsidiary, C.E. Lummus Inc., has been the contract manager on the Great Plains project. He has received $46,000 in directors' fees from Combustion Engineering over the past two years, according to his disclosure statement.

When questions about both men's financial interests were first raised in December, agency sources said they expressed resentment that their integrity might be questioned. Since then, they have not divested themselves of all their interests in the Great Plains companies.

"That stock is a fraction of what my family owns," said Reichl in a telephone interview last week. "It's inconsequential . . . . As a matter of principle, I don't think I should have to sell it."

Reichl, whose financial statement shows large stock holdings in numerous energy firms, said he told White House personnel officials nearly a year ago that he had no intention of selling the stocks just because he was taking a part-time job as a member of the agency's board of directors. His wife's trust, however, has sold about 1,200 of the 1,650 shares of American Natural Resources stock that it owned.

"The problem is really generic," Reichl said. "If you want a person who is supposed to be knowledgeable in the field, it's likely he's going to have something to do with the companies that are before the corporation."

MacAvoy has been even more emphatic. After Malone first raised the problem at the board's December meeting, MacAvoy fired off an angry letter denying that there was any conflict and rebuking the ethics official for raising the issue.

"That this was delivered as a public lecture in a board meeting was a piece of grandstanding totally out of keeping with operations in a corporation," MacAvoy wrote Malone.

Now the full five-member board must vote on whether Reichl and MacAvoy have legitimate conflicts or, in the language of the law that created the agency, whether their interests are "too remote or too inconsequential" to justify disqualification.

But the board faces another major problem. Approval of the $700 million in subsidies for Great Plains would require four affirmative board votes. If Reichl and MacAvoy are disqualified, the five-member board would be reduced to three members and won't be able to act.

Rep. Mike Synar (D-Okla.), chairman of the House Government Operations subcommittee on environment, energy and natural resources, raised this question last week in a letter to Synfuels chairman **Edward E. Noble**: Should Reichl be permitted to vote on MacAvoy's potential conflict and vice versa?

"This is potentially a serious problem," one agency official said when asked about the conflict question last week. "It could become a real aggravation."

—**Michael Isikoff**

Mr. SYNAR. Mr. Roberts, has Mr. Reichl indicated to you any change in his attitude?

Mr. ROBERTS. I have not discussed his attitude. I will examine the interest in terms of the consequential or remote nature of it.

Mr. SYNAR. Do you have any indication that he plans to sell his family interest in MidCon?

Mr. ROBERTS. I have no indication to that effect.

Mr. SYNAR. Does this holding represent a financial interest of Mr. Reichl's in Great Plains as defined under section 118 of the Energy Security Act?

Mr. ROBERTS. Yes.

Mr. SYNAR. Mr. Roberts, Mr. MacAvoy's most recent financial disclosure statement indicates that he is presently on the board of directors of Combustion Engineering, Inc., and holds stock in that company. His statement indicates that he has received more than $52,000 from Combustion Engineering since January 1, 1983.

Is this information accurate, to your knowledge?

Mr. ROBERTS. I believe it is, yes.

Mr. SYNAR. Now, Combustion Engineering's subsidiary, Lummus Crest, has served as project manager for Great Plains with prime responsibility for the quality, scheduling, and cost of all work done by the project contractors.

Is that not correct?

Mr. ROBERTS. Yes.

Mr. SYNAR. Lummus, along with Kaiser Engineering, has been responsible for over $1 billion worth of work on Great Plains for which the two companies will receive more than $28 million.

Is that correct?

Mr. ROBERTS. I would accept that, yes.

Mr. SYNAR. Mr. Roberts, on February 4, 1985, your predecessor, Owen Malone, wrote to Mr. David Martin, the Director of the Office of Government Ethics. This letter will be entered into the record as exhibit 5.

[The letter follows:]

United States Synthetic Fuels Corporation
2121 K Street, N.W. Washington, District of Columbia 20586 Telephone: (202) 822-6600

February 4, 1985

Mr. David H. Martin
Director, Office of Government Ethics
Office of Personnel Management
P. O. Box 14108
Washington, D.C. 20044

Dear Mr. Martin:

Mr. Paul W. MacAvoy has been nominated by the President for appointment to the Board of Directors of the United States Synthetic Fuels Corporation, subject to confirmation by the Senate. The position in question was created by Section 116(a)(2) of the Energy Security Act (the "Act") (P.L. 96-294), which established the Corporation and defines its authorities and those of its Board of Directors. The duties and obligations of a member of the Board are set forth in the Act. No other position description is available. A completed Financial Disclosure Report (SF-278) signed by Mr. MacAvoy is forwarded herewith. As the Corporation's designated Ethics Officer, I have reviewed Mr. MacAvoy's report in the context of the conflict of interest provisions of the Act and the Policy on Standards of Conduct approved by the Corporation's Board of Directors on June 17, 1982. This letter is addressed to you in compliance with Section 734.604(c)(iii) of the regulation governing the review of executive personnel financial disclosure reports.

The conflict of interest provisions applicable to Corporation personnel are set forth in Section 118 of the Energy Security Act and in the aforementioned policy. Section 118 of the Act makes applicable to the Directors of the Corporation the financial disclosure provisions of Title II of the Ethics in Government Act of 1978 that apply to individuals occupying positions compensated under the Executive Schedule. In addition, subsection 118(c) prohibits any Director from voting on any matter respecting any application, contract, claim, or other particular matter pending before the Corporation in which, to his knowledge, the Director has a financial interest. For purposes of this prohibition, the financial interests of a Director's spouse, minor child, partner or an organization in which a Director has any of several specified relationships including the negotiation of an arrangement for prospective employment, are attributed to that Director. This prohibition may be waived by the Board of Directors as to any particular matter if a majority of the Board determines that the financial interest is too remote or too inconsequential to affect the integrity of a Director's services as to that matter.

Mr. David H. Martin
February 4, 1985
Page 2

Section 118 of the Act also applies to the Directors of the Corporation the post-employment restriction contained in 18 U.S.C. 207(a) as if they were officers and employees of the executive branch of the United States Government. Section 207(a) prohibits permanently any former Corporation Director from representing any party other than the United States with respect to any particular matter in which the former Director, during his Corporation service, participated personally and substantially on behalf of the United States.

A principal focus of the Corporation's policy, which applies to all Corporation personnel, is on employee financial interests in participating organizations. For purposes of the policy, a "participating organization" means any organization or organizations undertaking a project involving the Corporation or formally proposing to undertake such a project. The term also includes other entities participating in such projects in a material way such as project-related financial institutions, investment bankers, and key construction, engineering, and other firms. A "financial interest" includes securities, partnership interests, or any right to receive financial benefits from such an organization, which is owned by the employee or a member of his household. The Corporation's policy does not require the divesture of such interests acquired prior to joining the Corporation, but prohibits the acquisition of any such interests while one is employed by the Corporation.

Schedule A of Mr. MacAvoy's financial disclosure report identifies a common stock holding by Mr. MacAvoy in Combustion Engineering, Inc. Schedule D reports that Mr. MacAvoy is also a member of the Board of Directors of Combustion Engineering, Inc. My review shows that a subsidiary corporation of Combustion Engineering, Inc., the Lummus Company has a current interest in a synthetic fuel project which has applied for financial assistance from the Corporation. Also, another of Combustion Engineering's subsidiaries, Lummus Crest, Inc. has evidenced an interest in a project now before the Corporation, but which appears to be inactive, in the event the sponsors of the project decide to go forward.

In my opinion, and depending on the particular matters to be voted on during his tenure as a member of the Corporation's Board of Directors, the reported financial interests involving Combustion Engineering, Inc. pose potential conflict of interest problems, and will require Mr. MacAvoy's close attention to the prohibition against voting and other requirements of Section 118(c) of the Energy Security Act. I have encountered no other problems in my review.

Based on my review, and subject to the foregoing, it is my opinion that Mr. MacAvoy's report evidences no conflict of interest under applicable laws and regulations. I so certify.

If I can be of further assistance in this matter, please let me know.

Sincerely,

Owen J. Malone
Ethics Officer

Enclosure

Mr. SYNAR. In this letter, Mr. Malone informs Mr. Martin that his review of Mr. MacAvoy's financial interest shows that "Lummus Company has a current interest in a synthetic fuels project which has applied for financial assistance from the Corporation."

Is it fair to assume that Mr. Malone was referring to the Lummus interest in Great Plains?

Mr. ROBERTS. I believe so, yes.

Mr. SYNAR. On April 1, Mr. Malone wrote to Mr. Charles Hugel, president of Combustion Engineering. That letter will be inserted in the record as exhibit 6.

[The letter follows:]

United States Synthetic Fuels Corporation
2121 K Street, N.W. Washington, District of Columbia 20586 Telephone (202) 822-6600

April 1, 1985

Mr. Charles E. Hugel
President and Chief Executive Officer
Combustion Engineering, Inc.
900 Long Ridge Road
P. O. Box 9308
Stamford, Connecticut 06904

Dear Mr. Hugel:

The U.S. Synthetic Fuels Corporation ("Corporation") is the federal entity responsible for administration of the program of federal financial assistance for synthetic fuel development authorized by the Energy Security Act of 1980 (P.L. 96-294, 42 U.S.C. 8711). As you know, Mr. Paul W. MacAvoy, a director of the Corporation also serves as a director of Combustion Engineering, Inc. ("CE"). My purpose in writing is to acquaint you with a letter I have addressed to Mr. S. H. Kreipke, President of Lummus Crest Inc. (copy enclosed) and to request from you whatever information CE may be able to provide me concerning the significance of CE's financial interest in the Great Plains Coal Gasification Project represented by the Lummus Company's present contract with Great Plains Gasification Associates, the sponsor of the Great Plains Coal Gasification Project in Mercer County, North Dakota.

The conflict of interest provisions of the Energy Security Act prohibit a director of the Synthetic Fuels Corporation from voting on any matter before the Corporation in which he or another organization he serves as a director has a financial interest. The prohibition includes not only direct and substantial financial interests, but indirect and insubstantial interests as well. The prohibition does not apply if the financial interest is disclosed and the Corporation's board of directors determines that the interest is too remote or too inconsequential to affect the integrity of the director's vote on the matter in question. As the Corporation's designated ethics official, it is my task to evaluate this interest with a view to reporting to Mr. MacAvoy and our board concerning the significance of this Lummus interest in the Great Plains project.

BEST COPY AVAILABLE

Mr. Charles E. Hugel
April 1, 1985
Page 2

The Corporation is well-along in its evaluation of the Great Plains proposal for financial assistance. It would be very helpful if CE could provide me, as soon as possible, with a statement concerning the value of CE's financial interest in Lummus' contract with Great Plains. A copy of CE's latest annual report and quarterly financial statements would also be helpful.

Again, the effort here is to develop a factual basis for evaluating the significance of this CE/Lummus interest in the Great Plains project. CE's assistance in this connection would be helpful and much appreciated. I am, of course, available to discuss the matter with appropriate members of your staff. If you or they have any questions, please let me know at (202) 822-6341.

Sincerely,

Owen J. Malone
Ethics Officer

Enclosure

cc: Hon. Paul W. MacAvoy

Mr. **Synar.** Mr. Malone requested information on the significance of Combustion Engineering's interest in Great Plains. And Mr. Malone notes that the Energy Security Act prohibits an SFC Director from voting on matters in which he or she has a financial interest. He states, "The prohibition includes not only direct and substantial financial interests but indirect and insubstantial interests as well."

Mr. Roberts, do you agree with Mr. Malone?

Mr. **Roberts.** Yes, an interest is an interest.

Mr. **Synar.** OK.

Now, on April 17, Mr. Kreipke of Lummus responded to Mr. Malone's April 1 request. That letter will be inserted into the record as exhibit 7.

[The letter follows:]

APR 22 1985

COMBUSTION ENGINEERING

Sven A. Kreipka
President and Chief
Executive Officer

April 17, 1985

Mr. Owen J. Malone
Ethics Officer
United States Synthetic Fuels Corporation
2121 K Street, N.W.
Washington, D.C. 20586

Dear Mr. Malone:

We have received your letter of March 29, 1985 to Lummus Crest Inc. and also a copy of your letter of April 1,1985 to Mr. C. E. Hugel of Combustion Egnineering, Inc. In both letters you have requested information about the status of Lummus Crest Inc.'s arrangements with Great Plains Gasification Association ("GPGA") with respect to the Great Plains Coal Gasification Project in Mercer County, North Dakota ("Project"). We understand you desire this information relative to your inquiry into a potential conflict of interest involving Mr. Paul W. MacAvoy who is a member of the board of directors of both Combustion Engineering, Inc. and the Synthetic Fuels Corporation. We are pleased to provide you the following information to assist you in your evaluation.

Lummus Crest Inc. participated in the Project as a partner in a joint venture with Kaiser Engineers, Inc. (now known as Raymond Kaiser, Inc.) with each party jointly and severally responsibile to GPGA for completion of the contract. The work of Lummus Crest Inc. under the contract with GPGA is now substantially completed. The plant is in operation and producing gas in both trains although it has not as yet been accepted. All Lummus Crest Inc. personnel have left the jobsite. Our work is now limited to answering questions from the field and in performing certain additional work items previously assigned to Lummus Crest Inc. by GPGA. Such items are expected to be completed in May of this year. Additionally, our partner, Raymond Kaiser, Inc. is working in the field completing construction of the final details of the plant. This work is also expected to be finished by May of this year.

Lummus Crest Inc.
A subsidiary of
Combustion Engineering, Inc.

1515 Broad Street
Bloomfield, New Jersey 07003

(201) 893-1515

As for our financial interests in the Project, Lummus Crest Inc. and Raymond Kaiser, Inc. have received all of the fees payable under the Project contract. The costs of the additional work items being performed by Lummus Crest Inc. as mentioned above are invoiced on a monthly basis. We expect to bill approximately $125,000 in April and about $20,000 in May. Lummus Crest Inc. and Raymond Kaiser, Inc. performed additional work outside the scope of the original Project contract. Approximately $150,000 of the fee for this extra work remains to be paid to the joint venturers and is expected to be paid in April 1985. Also, Lummus Crest Inc. and Raymond Kaiser, Inc. have received the amounts retained under the contract in exchange for which we were required to provide a bank guarantee in the amount of $4.2 million. This guarantee will expire on October 1, 1985.

The Project contract contains guarantees of performance and warranties of engineering design and field workmanship. The contract also defines the obligations of the joint venturers should the plant fail to perform as specified or for breach of warranty. Under the terms of an agreement dated November 30, 1984, GPGA and the joint venturers reached agreement upon a number of matters including the settlement of claims which had arisen up to the date of such agreement. Since such date no new claims have been asserted against the joint venturers other than a warranty claim against Lummus Crest Inc.'s Heat Transfer Services Division of about $50,000 for defects in certain superheaters purchased through such division. Resolution of this claim is pending. The performance guarantees and warranties contained in the Project contract will expire no later than November 1, 1985.

At present Lummus Crest Inc. does not have any other work for GPGA other than that described above. On one occasion we submitted a bid to GPGA to provide general engineering services for the Great Plains Coal Gasification Plant but this work was not awarded to us. However, Lummus Crest Inc. does wish to be considered eligible for any future work at the facility that may be awarded to GPGA.

In summary, our work on the Great Plains Project is essentially completed and I believe that the Project has only a minimal economic significance to Lummus Crest Inc. at the present time.

I trust the foregoing will be satisfactory for your purposes but if you should need any further information please feel free to contact me.

Very truly yours,
LUMMUS CREST INC.

S. A. Kreipke
President

SAK:as

cc: C. E. Hugel
Hon. Paul W. MacAvoy

Mr. **Synar**. In that letter, Mr. Kreipke describes the status of Lummus' financial interest in Great Plains. He explains that the Lummus work on Great Plains is "* * * essentially completed and I believe that the project has only a minimal economic significance to Lummus Crest Inc. at the present time."

He notes, however, that Lummus "does wish to be considered eligible for future work at the facility that may be awarded to GPGA."

Mr. Roberts, if Great Plains is shut down today, what would be Lummus' prospects for receiving "future work at the facility"?

Mr. **Roberts**. I would be speculating if I answered that positively or negatively, sir.

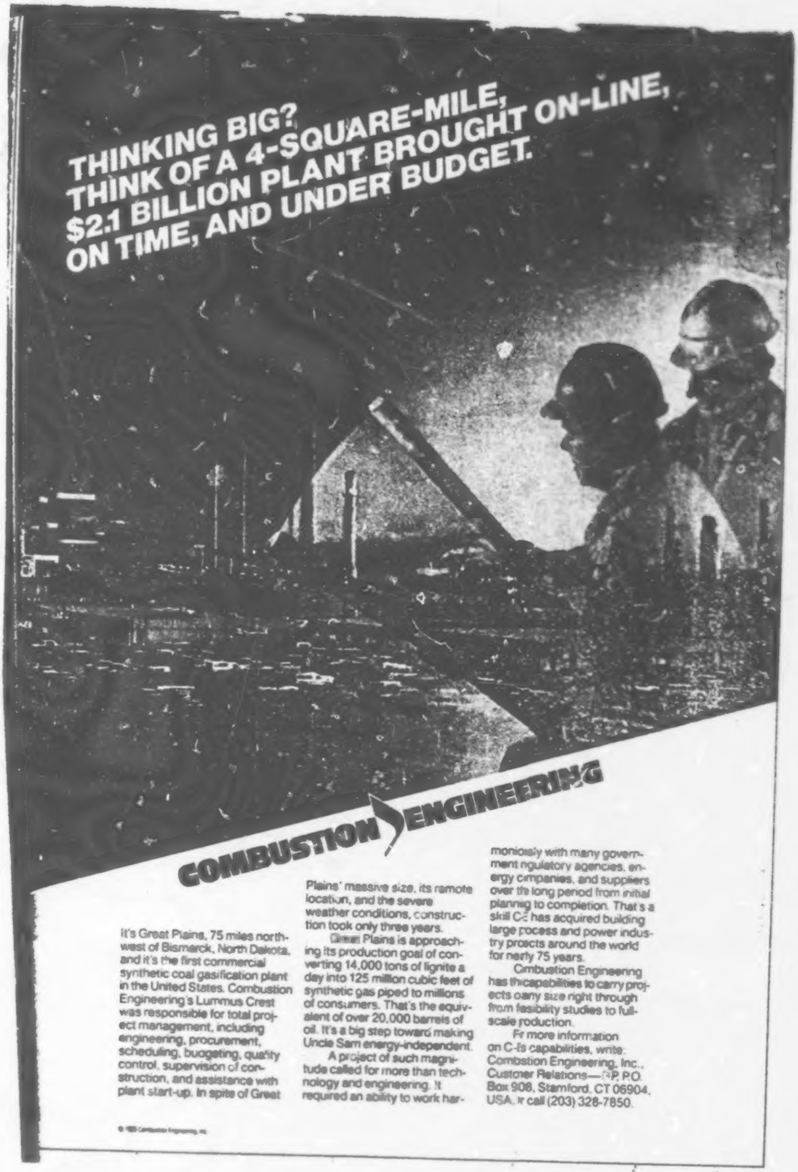
Mr. **Synar**. They won't be issuing any contracts if the plant closes, will they?

Mr. **Roberts**. I would accept that.

Mr. **Synar**. All right.

At this time I would like to insert into the record as exhibit 8 an advertisement which appeared in the Wall Street Journal on April 17, 1985.

[The article follows:]


THINKING BIG?
THINK OF A 4-SQUARE-MILE,
$2.1 BILLION PLANT BROUGHT ON-LINE,
ON TIME, AND UNDER BUDGET.
COMBUSTION ENGINEERING

It's Great Plains, 75 miles northwest of Bismarck, North Dakota, and it's the first commercial synthetic coal gasification plant in the United States. Combustion Engineering's Lummus Crest was responsible for total project management, including engineering, procurement, scheduling, budgeting, quality control, supervision of construction, and assistance with plant start-up. In spite of Great Plains' massive size, its remote location, and the severe weather conditions, construction took only three years.

Great Plains is approaching its production goal of converting 14,000 tons of lignite a day into 125 million cubic feet of synthetic gas piped to millions of consumers. That's the equivalent of over 20,000 barrels of oil. It's a big step toward making Uncle Sam energy-independent.

A project of such magnitude called for more than technology and engineering. It required an ability to work harmoniously with many government regulatory agencies, energy companies, and suppliers over the long period from initial planning to completion. That's a skill C-E has acquired building large process and power industry projects around the world for nearly 75 years.

Combustion Engineering has the capabilities to carry projects of any size right through from feasibility studies to full-scale production.

For more information on C-E's capabilities, write: Combustion Engineering, Inc., Customer Relations—[illegible]P, P.O. Box 908, Stamford, CT 06904, USA, or call (203) 328-7850.

© [illegible] Combustion Engineering, Inc.

Mr. SYNAR. This ad, paid for by Combustion Engineering, boasts of Lummus' responsibility for and success with Great Plains. It says:

> A project of such magnitude called for more than technology and engineering. It required an ability to work harmoniously with many government regulatory agencies, energy companies, and suppliers. Combustion Engineering has the capabilities to carry projects of any size right through from feasibility studies to full-scale production.

Mr. Roberts, if Great Plains is shut down, do you think Combustion Engineering will pay for similar ads in the future, boasting of their ability to build projects that don't operate?

Mr. ROBERTS. I don't believe that their accomplishment would be lessened by the future operational status of the plant. That's my reaction to your question.

Mr. SYNAR. Do you think that Combustion Engineering's prospects for building future synfuels plants could in any manner be improved by the SFC's approval of the $820 million package and successful operation of Great Plains?

Mr. ROBERTS. I can't speculate on that, Mr. Chairman.

Mr. SYNAR. Mr. Roberts, does Mr. MacAvoy have an existing and continuing financial interest in Great Plains?

Mr. ROBERTS. Yes, in the Combustion Engineering Corp.

Mr. SYNAR. Let me repeat the question.

Does Mr. MacAvoy have an existing and continuing financial interest in Great Plains?

Mr. ROBERTS. That is the question, sir. Combustion Engineering's participation was very large. As you indicated, it was done under the DOE loan guarantee aspect of it. The application before the Board is for a price guarantee for a product from an operating plant.

I don't know that at this point I can responsibly say that they have an interest in Great Plains. That's a very broad term.

Mr. SYNAR. Is there a financial interest as defined by the act? That's my question.

Mr. ROBERTS. In the matter before the Board?

The question I am struggling with, Mr. Chairman, is, as you have seen from the responses from Lummus Crest, and so forth, they feel that they are essentially out of the picture there. They are still doing work.

Mr. SYNAR. Are they out of the picture?

Mr. ROBERTS. They are still doing work. They still have guarantees in place.

Mr. SYNAR. Does that sound like they are out of the picture? Does "wish to be considered eligible for future work at the facility that may be awarded," take them out of the picture?

Mr. ROBERTS. I am not sure that that is of a formal enough nature to invest them with an interest in the future operations there. These are the questions I will have to consider.

Mr. SYNAR. What would you need to be sure, Mr. Roberts?

Mr. ROBERTS. I don't know of a future plan for construction there. I would say that's an expression of interest in future business.

Mr. **Synar**. Do you agree there will not be any future construction if the $820 million in assistance is not given? Do you agree with that?

Will there be any contracts let if they don't get the $820 million?

Mr. **Roberts**. I would say that in large operations of this sort, large projects which are already complete, there could be some mothballing operations which could be of some magnitude. I don't know. I have to depend on the technical people for that.

Mr. **Synar**. Mr. Noble and Mr. Corcoran, let me ask you this. Do you think that there is a conflict of interest or an appearance of a conflict of interest in these cases?

Mr. **Noble**. Mr. Chairman, those questions I leave totally up to the ethics officer. Congress set the policy and we set up a procedure to follow Congress' policy, and I turn those over to the ethics officer and legal counsel.

Mr. **Corcoran**. Mr. Chairman, under the procedure that has been established pursuant to the act that governs us, the determination on a financial interest matter is something for the ethics officer to evaluate. As he has indicated, he has not reached a conclusion on that.

Under the procedures involved, when the Great Plains matter would come before the Board of Directors of our Corporation for a vote, we would, before either casting our votes on that or determining who would be able to vote, respect and want the report of the ethics officer. So until we get the report of the ethics officer it would be premature for me to respond to your question.

Mr. **Synar**. Tom, do you understand where I am coming from here? You have got five members, two of which both have an appearance, let's say, at this point, of a financial interest in Great Plains, each of whose vote is required to determine whether the other one has a conflict of interest.

Mr. **Corcoran**. Mr. Chairman, I do understand your point.

Mr. **Synar**. OK.

Mr. **Corcoran**. But there are procedures, as you well know, involved, which have to be followed. We are following those procedures. I think that we are very sensitive to the concern that you have expressed. Obviously, the more difficult question probably in the end will be the matter of public confidence in whatever decision we reach.

I have my own thoughts on that at the moment, but I hope you would understand that until all the facts are in it would be premature for me to reach a conclusion.

Mr. **Synar**. Let me go back to Mr. Roberts.

Mr. Roberts, how long are you going to review this, and when do you plan to make a decision on this?

Mr. **Roberts**. I plan to work on it full time.

Mr. **Synar**. How long will that take once you start working on it full time?

Mr. **Roberts**. I can't estimate that. I am under constraint to do it as quickly as I can.

Mr. **Synar**. I apologize to my colleagues for taking 15 minutes instead of 5, and I will be more generous with the time.

Mr. Clinger?

Mr. **Clinger**. Thank you very much, Mr. Chairman.

As I understand the chairman's line of inquiry, he is suggesting that a vote for the restructuring by the two gentlemen mentioned could be influenced by the fact that there might be some financial benefit that would accrue to them by virtue of that vote.

You have indicated, I think, that it is, in fact, true that the Lummus Corp., in the case of Mr. MacAvoy, has completed, billed, and been paid for all of the work for which they had contracted. Is that not true?

Mr. ROBERTS. Yes, sir, they are still in a guarantee period.

Mr. CLINGER. There is no assurance that if the project does go forward, if the restructuring is to be approved at some point down the road, that the Lummus company would benefit from that decision, is there?

Mr. ROBERTS. Not to my knowledge, no.

Mr. CLINGER. Because the Lummus company would be in the position of any other potential contractor and would have to be bidding on the project, et cetera.

Mr. ROBERTS. I would think so, yes.

Mr. CLINGER. So, it seems to me that this is pretty highly speculative, that it takes a fairly large jump to reach the conclusion that a vote on that particular restructuring package would result in assured return or benefit to Mr. MacAvoy?

Mr. ROBERTS. Yes.

Mr. CLINGER. In the case of Mr. Reichl, it is my understanding that it is his wife who owns financial interests in a minority partner; is that correct?

Mr. ROBERTS. Yes, sir.

Mr. CLINGER. Do you have any indication of what portion of its earnings MidCon's involvement in Great Plains represents? How significant is their involvement?

Mr. ROBERTS. I have no firm figures before me. I believe we have a study being prepared, but I haven't had the advantage of it yet.

Mr. CLINGER. You do not have any present knowledge of what that percentage is?

Mr. ROBERTS. I think it is a very small percentage, but I really don't have the facts before me, sir, but that is a consideration.

Mr. CLINGER. That would be something that you would be seeking to determine as part of your investigation?

Mr. ROBERTS. Oh, yes, sir. Several factors such as that relationship and the nature of the company, the nature of its activity, the effect on net worth, and all that—these things have to come into consideration.

Mr. CLINGER. In other words, you would make a determination at the time that a vote would be taken on this issue as to the propriety of either Mr. MacAvoy or Mr. Reichl participating in that decision?

Mr. ROBERTS. That test would go to whether I could recommend that the Board find a remoteness or inconsequentiality in the interest involved, and I would so recommend yes or no. I haven't reached that point yet either.

Mr. CLINGER. Your recommendation would be whether or not they could participate in the decision?

Mr. **Roberts**. Whether or not the bar could be waived, if you will, on the basis that a member's interest was too remote or too inconsequential to affect the integrity of his vote.

Mr. **Clinger**. So it would be premature at this point to indict Mr. MacAvoy and Mr. Reichl for contemplating participation in this effort until you have completed——

Mr. **Roberts**. I am in the process but I have not completed it yet.

Mr. **Synar**. Will the gentleman yield for a second?

Mr. **Clinger**. Yes.

Mr. **Synar**. I want to get this correct for the record.

Mr. Roberts, you don't decide the conflict of interest, whether it is large or inconsequential. All you determine in your job, is whether or not the facts indicate there is "a financial interest." The determination of the impact of that financial interest is determined by the Board and its vote.

Mr. **Roberts**. That's right.

Mr. **Synar**. OK.

Mr. **Roberts**. But as the member who is under that disability would like to be permitted by the rest of the Board to participate, I would make a recommendation to the Board on how I saw the correlation between the interest and his net worth, and so forth.

Mr. **Synar**. But first you determine the financial interest?

Mr. **Roberts**. But I would not decide it, I would make a recommendation to the Board on that.

Mr. **Synar**. But first you determine a financial interest?

Mr. **Roberts**. Yes, in all cases, right.

Mr. **Synar**. Thank you.

Mr. **Clinger**. Just one final question.

Is it true that the act does not require either of the two Directors we are talking about to recuse himself from determining the remoteness of the other's interest?

In other words, is it permissible under the act for Mr. MacAvoy to participate in a decision as to Mr. Reichl's remoteness and Mr. Reichl to participate in a decision regarding Mr. MacAvoy's?

Mr. **Roberts**. Mr. Clinger, that's not my call. I believe the general counsel would address that question because that is a legal question of procedure under the Board.

Mr. **Clinger**. It was my understanding that a Director must only recuse himself from his own determination of remoteness.

Mr. **Roberts**. I would defer to the general counsel.

Mr. **Clinger**. Could you respond to that, sir?

Mr. **Rawicz**. Yes, that is part of the statute that has given us some concern, that the statute does provide that the member who was seeking a remoteness type vote not vote. Our concern is whether that was the only party that would not vote or would it be the other Directors that may have a financial interest with regard to the project at hand.

We have informally advised the members of the Board that we would take a more expansive interpretation of the statute which would say that if another member had a financial interest in the matter before the Board, we would have to take a look at what that matter was, that he should not vote on the remoteness issue of another Director who had a financial interest in that same matter.

Mr. **Clinger**. OK. So you are interpreting the statute, then, to preclude him from voting not only on his own but——

Mr. **Rawicz**. Yes, it is not an open and shut case, but that's how we would interpret the statute.

Mr. **Clinger**. On a case by case basis?

Mr. **Rawicz**. That's right. You would have to take a look at what the particular matter is, what is the vote that we are looking at, the interest of the Directors.

Mr. **Clinger**. In the nature of the interest of each party involved?

Mr. **Rawicz**. That's right.

Mr. **Clinger**. OK.

Thank you very much, Mr. Chairman.

Mr. **Synar**. Mr. Armey?

Mr. **Armey**. No questions, Mr. Chairman.

Mr. **Synar**. Let me add at this point, I would like to enter into the record exhibit 9, based upon what you just said, Mr. Roberts. This is a legal brief prepared by the American Law Division of the Congressional Research Service, which agrees with the proposition that you just made.

[The document follows:]

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

April 16, 1985

To: Environment, Energy and Natural
Resources Subcommittee
House Government Operations Committee
Attention: Rick Young

From: American Law Division

Subject: Procedure For the Disqualification of a Director
Of the U.S. Synthetic Fuels Corporation From Participation
in a Decision Because of a Conflict of Interest

This will respond to your inquiry and our conversations regarding the proper procedure for the disqualification of a director of the U.S. Synthetic Fuels Corporation from participation in a decision to award financial assistance because of a conflict of interest. Specifically, you have asked whether or not two directors, each of whom might have a potential conflict of interest, could vote on the question of the other's participation in the decision to award financial assistance. You have also asked that we review the doctrine of administrative necessity to ascertain whether, despite conflicts of interest, the Board is compelled to make decisions regarding financial assistance.

Your questions arise, and are particularly important, because there are currently only five members serving on the Board of Directors of the Corporation.

Important to the resolution of the legal questions that you have asked are several provisions of the Energy Security Act, Public Law 96-294, 42 U.S. Code

Sections 8701 et seq., which established the U.S. Synthetic Fuels Corporation.

Quorum and Majority Voting Requirements

Section 116(a)(2) of that Act created the Board of Directors of the Corporation to consist of a Chairman and six other Directors to be appointed by the President with the advice and consent of the Senate. With respect to quorum requirements for the conduct of official business by the Board of Directors, Section 116(e) provides, in pertinent part:

> A majority of the Board of Directors shall constitute a quorum, and any action by the Board of Directors shall be effected by majority vote of all members of the Board of Directors.

On its face, the quorum and voting requirements of the statute seemingly raise the question of whether or not a quorum is comprised of a majority (four) of the total number of Directors authorized under the statute (seven), a majority (three) of the number of sitting Directors (currently five because of two vacancies), or a majority of those validly able to participate (by virtue of no disqualifying conflict of interest, see infra) in a particular decision.

The legislative history of the Energy Security Act provides substantial illumination on the construction that should be given to the quorum and majority voting provisions of the Act. The House Committee on Banking, Finance and Urban Affairs had already reported a bill to amend the Defense Production Act to provide new synthetic fuels authority (see, House Report 96-165, 96th Cong., 1st Sess. (1979)) when the Senate Committees on Banking, Housing, and Urban Affairs and Energy and Natural Resources began to consider new synthetic fuels authority.

The Senate Committee on Banking, Housing, and Urban Affairs reported amendments to the Defense Production Act. See Senate Report 96-387, Part I, 96th Cong., 1st Sess. (1979). The Senate Committee on Energy and Natural

Resources, however, reported the version of the legislation establishing the U.S. Synthetic Fuels Corporation. See Senate Report 96-387, Part II, *supra*. The Senate Energy Committee version of the bill and the version of the bill first passed by the Senate contained the following language with respect to the quorum and voting majority of the Board of Directors for the Corporation:

> A majority of the Directors *serving in a voting capacity* shall constitute a quorum, and any action by the Board shall be effected by majority vote of all members of the Board *serving in a voting capacity*. (emphasis added) "Compilation of the Energy Security Act of 1980, and 1980 Amendments to the Defense Production Act of 1950," (hereinafter "Compilation") Committee Print 96-17 (3 Parts), House Committee on Banking, Finance and Urban Affairs, 96th Cong., 2d Sess. (1980), Part 3, at 1544, Section 112(e).

The term "voting capacity" appears to have had a potentially dual meaning in the Senate Energy Committee version. First, the Senate Energy Committee bill would have established a Board of Directors consisting of five members "in a voting capacity" (appointed by the President with the advice and consent of the Senate), and the Chairman of the Energy Mobilization Board (a post to have been created in companion legislation that was never enacted), the Secretary of Treasury, and the Secretary of Energy "in a nonvoting and ex-officio capacity." Compilation, *supra*, Part III, at 1542, Section 112(a)(2). Only the five members appointed to the Board had "voting capacity."

The second potential meaning of "voting capacity" relates to the possible disqualification of a Director due to a conflict of interest. The Senate Energy Committee version, and the version passed originally by the Senate, contained a conflict of interest provision virtually identical to that ultimately enacted. Compilation, *supra*, Part III, at 1546-1548, Section 114. Because a Director could be disqualified from participating due to a conflict of interest, and because he would be proscribed from participating in the Board consideration of his conflict of interest (see, discussion *infra*), a Director under the Senate Energy Committee version could also be said to "lack voting capacity" under those circumstances.

At Conference Committee, the quorum and majority voting provisions were changed to the final version eventually enacted as Section 116(e), supra, by eliminating the language relating to "voting capacity." In addition, the Board was expanded to seven members. The Secretary of Treasury, the Secretary of Energy, and the Chairman of the Energy Mobilization Board were dropped as ex officio members of the Board, although an advisory committee was established on which they had seats under Section 123 of the Act. The Conference Report in its summary merely acknowledges the change, without specifying the reasons for it:

> Subsection 116(e) provides for meetings of the Board of Directors as specified in the bylaws which provides that a majority of the Directors shall constitute a quorum; however, any action of the Board of Directors shall be effected only by majority vote of all Directors. House Conference Report 96-1104, 96th Cong., 2d Sess. (1980), at 204.

On final passage of the legislation by both the House and the Senate, there appears to be only one comment made on the floor with respect to quorum and voting majority requirements. That comment, however, is particularly instructive in light of the changes made without other apparent explanation in the Conference Committee. Congressman John Dingell, then Chairman of the Subcommittee on Energy and Power of the House Committee on Energy and Commerce and a supporter of the legislation, made this observation:

> We have insured that all views of the Board will be heard by requiring, in section 116(e), that any action of the Board must be by a majority vote of all members of the Board, meaning that no action shall be effective unless it has the support and vote of at least four members of the Board. Compilation, supra, Part 1, at 409.

Thus, it would appear that the two provisions governing the necessary quorum and voting majority of the Board of Directors, taken together, require that at all times the conduct of official business by the Board of Directors be accomplished at a meeting at which at least four Directors are present and voting in the affirmative on any matter. "All members" was understood to mean "all authorized members of the Board of Directors."

For these reasons, it would appear that the construction of the statute in light of its legislative intent does not raise the interpretative possibilities that have allowed courts, in the absence of express statutory provisions or adequate manifestations of legislative intent, to conclude that "majority" voting requirements mean a simple majority of a quorum. See, *Federal Trade Commission v. Flotill Products, Inc.*, 389 U.S. 179 (1967); *Assure Competitive Transportation v. United States*, 629 F.2d 467 (7th Cir. 1980); and, *Railroad Yardmasters of American v. Harris*, 721 F.2d 1732 (D.C. Cir. 1983). See also, *Braniff Airways, Inc. v. Civil Aeronautics Board*, 379 F. 2d 453 (D.C.Cir. 1967); *David B. Lilly Co. v. United States*, 571 F.2d 546 (Ct. Cl. 1978); and, *City of Charlottesville v. Federal Energy Regulatory Commission*, 661 F. 2d 945 (D.C. Cir. 1981).

Conflicts of Interest

In Section 118(a) of the Act, Congress provided that the financial disclosure provisions of the Ethics in Government Act of 1978 would apply to the Directors, officers, and certain employees of the Corporation. And in Section 118(c), Congress established statutory procedures governing the participation of Directors with certain conflicts of interest in official decisions of the Board:

> (1) Except as permitted by paragraph (3), no Director shall vote on any matter respecting *any application, contract, claim, or other particular matter pending before the Corporation*, in which , to his or her knowledge, he or she, his or her spouse, minor child, partner, or organization (other than the Corporation) in which he or she is serving as officer, director, trustee, partner, or employee, or any person or organization

> with whom he or she is negotiating or has any arrangement concerning prospective employment, has a financial interest.
> (2) Action by a Director contrary to the prohibition contained in paragraph (1) shall be cause for removal of such Director pursuant to section 116(b)(3), but shall not impair or otherwise affect the validity of any otherwise lawful action by the Corporation in which the Director or officer participated.
> (3) The prohibition contained in paragraph (1) shall not apply if the Director first advises the Board of Directors of the nature of the particular matter in which he or she proposes to participate and makes full disclosure of such financial interest, and the Board of Directors determines by majority vote that the financial interest is too remote or too inconsequential to affect the integrity of such Director's services for the Corporation in that matter. The Director involved shall not participate in such determination. (emphasis added)

The legislative history of this provision sheds little light on the instant question. See generally, Compilation, supra. See specifically, House Conference Report on the Energy Security Act, House Report 96-1104, 96th Cong., 2d Sess. (1980), at 206; and, Senate Report 96-387, 96th Cong., 1st Sess. (1979), at 165-166.

However instructive a more expansive legislative history of this provision might have been, it would probably only provide supplemental support for the plain reading of the statute. On its face the statute establishes a general rule proscribing a Director from voting on "any matter" respecting financial activities of the corporation or any "other particular matter pending before the Corporation" in which he, certain of his relatives, or certain of his business associates have a financial interest.

The general prohibition is subject to the process of disclosure of the nature of the financial interests regarding the potential conflict of interest and Board consideration of the question of whether or not the financial interest is too remote or too inconsequential to require the Director to refrain from voting on the particular matter. Thus, taken together the two provisions--the general rule and the procedure for Board review of conflicts of interest--vest with the other members of the Board the clear responsibility of determining the degree of the conflict of interest another member of the Board might have in close cases for the sole purpose of deciding whether that member should participate in a specific decision of the Board.

However, these requirements do not leave the determination of conflicts of interest as a matter of discretion solely with the Board of Directors. Participation in Board decisions when there is significant conflict of interest relating to the matter is an express statutory basis for removal of the Director by the President under Section 116(b)(3) of the Act.

In addition, the statute proscribes the member of the Board from participating in the decision regarding whether or not his own conflict of interest is inconsequential or remote. Thus, until the Board affirmatively decides that a potential conflict of interest put before it for a determination of whether or not it is inconsequential or too remote is, in fact, too inconsequential or remote to warrant a Board decision to deny participating in a certain matter, a Director is prohibited from participating in "any matter" concerning the potential conflict of interest. "Any matter" would seem quite clearly to include participating in a decision respecting whether or not a potential conflict of interest relating to the same matter of another Director is inconsequential or too remote.

This plain reading of the statute clearly leaves open the possibility that under current circumstances with two vacancies on the Board of Directors the existence of potential conflicts of interest on the part of two Directors with respect to the same matter would render the Board incapable of reaching a decision on that matter because a quorum could not be mustered to decide whether or not the conflict of interest of even one of the Board members was too inconsequential to warrant Board disqualification of that member. If two Directors had potentially disqualifying conflicts on the same matter, neither could vote on either his own participation or the participation of the other until each had been affirmatively allowed to participate by the vote of the other members of the Board. Since only three other members presently exist, they do not constitute an adequate quorum to make the conflict of interest decision on either or both of the two members with the potentially disqualifying conflicts of interest.

While this result may have the effect of temporarily paralyzing the Board of Directors on that matter, the statutory scheme contemplates a variety of circumstances under which the Board would not be able to act for want of an adequate quorum. First, the mere absence from meetings could prevent the assembly of a quorum under Section 116(e). Second, the simultaneous occurrence of four vacancies on the Board of Directors, because of death, resignation, or removal could prevent the assembly of a quorum under Section 116(e). Third, even with a full complement of Directors it is not wholly inconceivable that a matter would arise in which a majority of the Board had disqualifying conflicts preventing the consideration of some matter until the conflicts were removed. And finally, as is the case now, a combination of vacancies, conflicts of interests, and absences would also prevent the establishment of a quorum adequate to consider a certain matter or a valid majority in support of a decision adequate to allow it to be made.

Quite clearly, the imposition of a conflict of interest provision that disqualifies an adequate majority for action implicitly and strongly suggests that such action should not be taken. If one member should not participate because of a conflict, a fortiori, the Board should not act at all when a majority has a conflict. Or said another way--the way in fact in which Congress wrote the statute--when a valid and qualified majority is lacking, no action can be taken by the Board. To conclude otherwise would frustrate the very purposes Congress obviously intended and clearly set forth in the organic statute establishing the Corporation.

The Rule of Necessity

As summarized by Kenneth Culp Davis, the rule of necessity prevents the disqualification of administrators or judges where no other authoritative decision-maker is available:

> Most of the decisions that judges or administrators are not disqualified are...reinforced with reliance on the idea that the tribunal would have to act even if it were disqualified, for otherwise the organs of justice would be unavailable. Davis, Kenneth Culp, Administrative Law, (West Publishing Co. 1951), at 382.

There have been several cases that have applied the rule of necessity in upholding the actions of judges and federal administrators. Perhaps, the most famous is Evans v. Gore, 253 U.S. 245 (1920), in which the Supreme Court of the United States, despite its own obvious interest in the outcome, was forced to address the issue of the constitutionality of an income tax that would have the effect of reducing the salaries of judges and the President in conflict with the constitutional proscriptions against such reductions. The Court made this important observation:

> Stated in its broadest aspect, the contention involves the power to tax the compensation of federal judges in general,--and also the salary of the President, as to which the Constitution (Art. II, Section 1, cl. 6) contains a similar limitation. Because of the individual relation of the members of this court to the question, thus broadly stated, we cannot but regret that its solution falls to us; and this although each member has been paying the tax in respect of his salary voluntarily and in regular course. But jurisdiction of the present case cannot be declined or renounced. The plaintiff was entitled by law to invoke our decision on the question as respects his own compensation, in which no other judge can have any direct personal interest; and there was no other appellate tribunal to which under the law he could go. He brought the case here in

> due course, the Government joined him in asking an early determination of the question involved, and both have been heard at the bar and through printed briefs. In this situation, the only course open to us is to consider and decide the cause,--a conclusion supported by precedents reaching back many years. *Moreover, it appears that, when this taxing provision was adopted, Congress regarded it as of uncertain constitutionality and both contemplated and intended that the question should be settled by us in a case like this.* (emphasis added) *Evans*, *supra*, at 247-248.

Several points should be made about the rationale set forth by the Court in *Evans* and its possible applicability to the Synthetic Fuels Corporation. First, the nature of the Corporation is vastly different from a court or administrative agency required to consider and decide matters within its jurisdiction. The Corporation provides financial assistance to private enterprise--a purely gratuitous activity on the part of the Federal Government. No party has a legally enforceable right to assistance and a party may not have a legally enforceable right to Corporate consideration of possible assistance. Alternatively, fundamental rights of due process compel judicial and administrative action under the rule of necessity, otherwise a party might be denied a remedy to which he would otherwise be entitled. Second, Congress not only did not manifest an intent, as in *Evans*, that the Corporation consider financial assistance despite conflicts of interest of the Board of Directors, Congress manifest an express intent to the contrary in its proscription of participation because of conflicts of interest. Third, the rule of necessity is most often applied where an inherent or institutional conflict of interest arises and not, as here, where an individual conflict occurs. Individual administrators and judges often recuse themselves, without creating a situation appropriate for the application of the rule of necessity. And finally, any temporary inability to act can be resolved in several fashions by the Board because the conflicts of interest are not interminable as in *Evans*. Directors can dispose of financial interests under their own control in order to terminate some conflicts. They can also resign--an act that arguably might be required in light of the related obligations of each director under the Act to faithfully discharge the duties of Director (Section 116(d) of the Act) and not to neglect duty or commit malfeasance in office (Section 116(b)(3) of the Act). Or, the President can fill the two vacancies on the Board, thereby easing the achievement of a quorum and voting majority where there are one or two disqualifying conflicts of interest.

The line of cases preceding and following Evans is long. See for example, Southern Pacific Co. v. Board of Railroad Commissioners, 78 F. 236 (N.D. Cal. 1896); Montana Power Co. v. Public Service Commission, 12 F. Supp. 946 (D. Mont. 1935); Loughran v. Federal Trade Commission, 143 F. 2d 431 (8th Cir. 1944); Mayor of City of Everett v. Superior Court, 324 Mass. 144, 85 N.E.2d 214 (1949); Scannel v. Wolff, 86 Cal. App. 2d 489, 195 P. 2d 536 (1948). However, in each of these instances the "necessity" created can be differentiated from any compelling need of the Corporation to act for the reasons indicated above.

Thus, it would seem that the rule of necessity provides little valid rationale for Corporation action despite the inability to marshall an adequate quorum and qualified voting majority to consider one specific case. The arguments in favor of adhering, instead, to Congress' clear directive to avoid conflicts of interest carries with it a very clear overriding public purpose.

Conclusion

For the reasons set forth above, we believe that it would be inappropriate for two Directors, each having a potentially disqualifying conflict of interest regarding the possible award of financial assistance to the same firm, to vote on the question of the other's conflict of interest in order to achieve an adequate majority. When, as now, the Board only has five sitting Directors, the occurrence of two potential conflicts of interest prevent the ruling on the questions of the conflict and, therefore, the decision on the merits of the award of financial assistance. The rule of necessity would not require the Board to proceed irrespective of conflicts of interest because of some overriding interest in having a decision on the financial assistance made. To conclude otherwise would ignore the clear language of the statute with regard to quorums and voting majorities and would frustrate the clear purpose of Congress in proscribing participation of Directors in decisions in which they had a conflict of interest.

We trust that the foregoing has been responsive to your inquiry.

Robert D. Poling
Specialist in American Public Law
American Law Division

Mr. **Synar**. The brief discusses the procedure for disqualification of an SFC Director from participation in a decision because of conflict of interest. It reviews whether two Directors, each of whom might have a potential conflict of interest, can vote on the question of each other's participation in the decision to award financial assistance to the project.

It also reviews the doctrine of administrative necessity to determine whether, despite conflicts of interest, the SFC Board is compelled to make decisions regarding financial assistance.

The American Law Division reached this conclusion:

> We believe that it would be inappropriate for two Directors, each having a potential disqualifying conflict of interest regarding the possible award of financial assistance to the same firm, to vote on the question of the other's conflict of interest in order to achieve an adequate majority. When, as now, the Board only has five sitting Directors, the occurrence of two potential conflicts of interest prevent the ruling on the questions of the conflict and, therefore, the decision on the merits of the award of the financial assistance. The rule of necessity would not require the Board to proceed irrespective of conflicts of interest because of some overriding interest in having a decision on the financial assistance made. To conclude otherwise would ignore the clear language of the statute with regard to quorums and voting majorities and would frustrate the clear purpose of Congress in proscribing participation of Directors in decisions in which they had a conflict of interest.

Now, that is what you agreed to; is that correct?

Mr. **Rawicz**. I agree with the conclusion on the issue of the rule of necessity. We have taken a look at that ourselves. We generally come up with the same conclusion, though, there really is no direct case in point. In concept, the issue of not having sufficient Directors for a vote would not normally make the rule of necessity applicable.

What situations would make the rule necessity applicable, that is, permitting a Director to vote even though he had a financial interest, is not clear. I think that's a novel question that hasn't been looked at.

Mr. **Synar**. Mr. Noble, given the facts that we have just explored here in the last 20 minutes, can the SFC legally take action on Great Plains?

Mr. **Noble**. Mr. Chairman, on questions of that nature I refer to the counsel.

Mr. **Rawicz**. Could I add a point?

We have always felt that it is necessary for the ethics officer to do his review close to the vote. If you take the case of Mr. Reichl when he was first appointed as a Director, he had a stock interest in three of the five partners—he now has a stock interest in one of the five partners. Whether he retains that interest, would be looked at at the time of the vote and we can't speculate, though we have read the article that said he didn't intend to sell it but he may decide to change that.

The relationship of the other member, Mr. MacAvoy, we know what that is, but that could change, too, at the time of a vote. So we can't really answer the legal question until we get ready to vote.

Mr. **Clinger**. Will the gentleman yield?

Mr. **Synar**. Yes, I will yield.

Mr. **Clinger**. With regard to Mr. MacAvoy, given the present circumstances where we know that Mr. MacAvoy's interest is in the Lummus Corp., that the Lummus Corp. has completed all work, and has been paid for all work, is no longer involved, all we have is that Lummus potentially could be involved at some point down the line. But even that's very speculative given the fact that any number of firms that could be involved in this work could be granted the contract.

Does that strike you as an inhibition to permit Mr. MacAvoy to participate?

Mr. **Rawicz**. I will refrain from that since that is not my call, it's the ethics officer's call. But I will say, historically, the prospect of somebody getting business, being one of the bidders being successful, saying I have done a good job and I can get more business, has not been considered by the Corporation as being a participating organization—such that we would look for a financial interest. So, seeking business and advertising for business has not been considered to be a financial interest.

But as to whether the fact situations at hand represent a financial interest, that is not my call.

Mr. **Clinger**. In fact, it might actually work against the Lummus Corp. because it might be that Lummus would not be permitted to participate in bidding on whatever the work might be. Isn't that true?

Mr. **Rawicz**. I don't think that kind of a determination would be made. Whether Lummus participates or not, I think is dependent on what the SFC does. That's a call by the project sponsor and not us, who is the best contractor, the best individual to do a job.

Mr. **Clinger**. Thank you.

Mr. **Synar**. Tom, the question, to remind you, is can the SFC legally take action on Great Plains?

Mr. Corcoran. I think the answer to that question depends on the facts that our ethics officer would have to develop on the financial interest. I think with respect to the report of the Congressional Research Service that that is a policy that we should adopt.

Mr. Synar. Let me again thank all of you for coming. I know we have been here for a long time but we had a lot of information to get through. I appreciate all of you being here.

I do want to express one more time, not on a sour note, but I hope that the message will be sent to the other two Directors who are not here today, that our invitations to appear before this subcommittee are not invitations for tea. They are invitations which we take seriously and to which we expect a response.

Again, thank you for your time and effort. We hope that you will stay around for the final two panels.

Our next panel will be Mr. Jan Mares, Assistant Secretary for International Affairs and Energy Emergencies, Department of Energy, accompanied by Mr. Dave Dashevsky, project manager, and Mr. John Panek, financial monitor.

Do any of the three of you gentlemen have any objection to being sworn in?

[Witnesses sworn.]

Mr. Synar. Let me, first of all, apologize for the lateness. Obviously, we didn't intend to keep you over this long. I know that you just got in at 1:30, Jan, and I appreciate your diligence.

In order to try to get to the questions as quickly as possible, your entire testimonies will be put into the record, and if you could summarize in less than 5 minutes, I think we can get you out of here pretty quickly.

STATEMENT OF JAN W. MARES, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS AND ENERGY EMERGENCIES, DEPARTMENT OF ENERGY, ACCOMPANIED BY DAVE DASHEVSKY, PROJECT MANAGER, AND JOHN PANEK, FINANCIAL MONITOR

Mr. Mares. Thank you, Mr. Chairman.

I first want to thank you for changing the hearing date from Monday till today to accommodate a commitment I had on behalf of the Government, and I appreciate that.

I also apologize to you for the delay in providing the testimony to you until yesterday afternoon. We tried as hard as we could to meet your Monday request and just couldn't.

Third, in proofing the testimony, there are some errors in it that I have put on a separate sheet that I would like to have attached or in effect have the final testimony corrected.

Mr. Synar. Without objection, that will be inserted in the record.

Mr. Mares. Thank you very much.

I think there are several points as to which there is clear consensus on this project. I think, first, the Nation will get value from the operation at Great Plains for an extended period.

I think, second, the Government itself should not operate the Great Plains project because the Government is not going to be the ultimate manufacturer of synfuels. The private sector will be the operator of the synfuels projects.

Third, I think that all of us are striving, the SFC, the executive branch, and the legislative branch, to come up with the least expensive way, from the standpoint of the Government, from a budget and a deficit and a cash-flow standpoint, to have this project go forward.

Fourth, the Great Plains sponsors clearly have the right today to withdraw from the project without repaying the Federal Financing Bank (FFB) loan.

Finally, I think it is also clear that the Great Plains sponsors have done an outstanding job of managing and operating the project to date.

It appears that the project can, in most years, generate some cash in addition to its variable operating costs. If this were a purely commercial venture, it would probably not be shut down tomorrow, because of the fact that there are some contributions to fixed charges that are generated in almost each year. But that does not change the proposition of what the total earnings of the project are in each year or the total cash-flow, when you take into account all of the fixed charges.

Finally, clearly extended operation of the project is desired. I think that from the standpoint of the Department and the administration, we are not opposed to a price support agreement; indeed, we believe one may well be required in this case. However, there is no administration interest in providing a large Federal subsidy for only a brief period of operation.

So the issue is, how do we get the risks and benefits allocated? And how do we get the plant operating, an operation for an extended period of time at the least cost to the Government? I think to that end, further negotiation is going to be appropriate.

I would like to raise at this time what I think is a perspective, a very valid engineering perspective on projects, that has been held true in this case and in all the projects that I have ever been involved with—and there are in fact seven phases of a project. The first is uncritical acceptance. The second is wild enthusiasm. The third is dejected disillusionment. The fourth is total confusion. The fifth is search for the guilty. Sixth is punish the innocent. Finally, promote the nonparticipants.

I would be happy to answer your questions, Mr. Chairman.

[The prepared statement of Mr. Mares follows:]

STATEMENT OF JAN W. MARES

ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS AND ENERGY EMERGENCIES

Department of Energy

Before the

Subcommittee on Environment, Energy and Natural Resources
of the Committee on Government Operations

U.S. House of Representatives

May 22, 1985

ERRATA

Testimony of Jan W. Mares,
Assistant Secretary for
International Affairs and
Energy Emergencies
Department of Energy

before the
Subcommittee on Environment, Energy
and Natural Resources
Committee on Government Operations
House of Representatives
May 22, 1985

Page 3, line 5 - change "this" to "a"

Page 3, line 11 - should read: "...Project at least through 1989."

Page 3, line 24 - change "the" to "a"

Page 15, line 1 - should read: "synthetic gas had been sold..."

Page 17 - add new paragraph at bottom of page as part of key points: "However, the Project itself is likely to have operating revenues higher than variable operating costs for many years."

Page 24, line 23 - change "investor" to "internal"

Page 36, line 13 - and line 14 should read in its entirety: "least until there has been lengthy operation of the Project."

Page 38, line 21 - change "Option III" to "Option V"

Introduction

Good morning Mr. Chairman. It's a pleasure to appear before you to testify on the Great Plains Gasification Project (Project). The last time I presented formal testimony on this subject was October 18, 1983. Much has happened in the intervening year and a half. Most important, perhaps, is the fact that on July 28, 1984, the first synthetic gas was produced by Great Plains and was sold and shipped to the Northern Border Pipeline. Just this past April, Great Plains accomplished, for one day, near design rate production by producing 136 MMCF and delivering a total of 130 MMCF to the pipeline. In addition, 90 tons a day of anhydrous ammonia is being sold as fertilizer, and 85 tons per day of sulfur are being produced and sold. The issue currently before us is the price guarantee assistance package agreement (price supports) negotiated between the sponsors of the Great Plains Project and the United States Synthetic Fuels Corporation (SFC) staff. We are not opposed to a price support agreement. Indeed, we believe it may well be appropriate in this case. However, there is no Administration interest in providing a large Federal subsidy for a brief period of operation. Since the information gained from lengthy operation of the plant is a major National benefit from its operation, we belive every effort should be made in negotiating such an agreement to ensure long-term operation of the plant and maximum additions to the synthetic fuels data base. Today, in my testimony, I intend to show why DOE and the Administration urge the Board of Directors of SFC approve and execute an appropriate price guarantee agreement as soon as reasonably possible.

In 1982 the Department of Energy (DOE) concluded a $2.02 billion Loan Guarantee Agreement with the sponsors of the Great Plains Project. Through May 17, 1985, $1.46 Billion has been borrowed by the Project from the Federal Financing

Bank (FFB) and the sponsors have invested $535.5M in equity in the Project. DOE has guaranteed the FFB loan and has a loan reserve fund of $673 million to a pay off the FFB loan in event of default or withdrawal by the sponsors from the Project.

If DOE must pay FFB more than the $673 million in the event of such a default or withdrawal or if the sponsors withdraw from the Project and DOE needs appropriated funds to try to operate the plant pending its ultimate disposition, DOE will have to request such funds from Congress. DOE has no appropriated funds for such purposes. Since the purpose of such funds would be related to synfuels, DOE would recommend that the Administration request Congress to allocate to DOE from the United States Synthetic Fuels Corporation's (SFC) existing appropriation, such funds as are required to pay off the FFB or to operate the plant.

The Project has been completed essentially on time and under budget. The Project is now providing very valuable technical, environmental, and socioeconomic information. This is the policy reason the Project was provided federal assistance by DOE under the Loan Guarantee Agreement (LGA).

Unfortunately for the Project, although fortunately for the Nation, actual and projected oil and gas prices today and in the future are significantly lower than forecast in 1982. As a result the financial outlook for the Project is very unfavorable. The outlook is so poor that the sponsors have, and have had since early 1983, the right to withdraw from the Project leaving the outstanding debt unpaid. They would have to repay certain tax benefits, but these will not offset the outstanding loan at this time. If the sponsors withdraw, DOE has three unattractive options (a) abandon the Project for scrap; (b) run the Project as a Government-Owned Contractor Operated (GOCO) facility; or (c) try to sell the Project to a third party; or some combination thereof. These options are fraught with many uncertainties and potentially difficult problems.

The DOE and the Administration believe this price guarantee assistance agreement is likely to have more tangible and intangible benefits for the U.S. taxpayers, the Nation and the U.S. Government than if such agreement is not concluded with the sponsors and they terminate their participation in the Great Plains Project. This conclusion is based on our analysis and evaluation which indicates there are significant financial, operational and information collection benefits if the sponsors continue with the Project through 1989. The price guarantee package substantially increases the likelihood of such continuation. However, proceeding with the proposed price guarantee assistance agreement is not necessarily the lowest cost alternative to the Government. There are some scenarios whereby an abandonment by the sponsors of their participation in the Great Plains Project may provide a greater cash return to the Government in its entirety than proceeding with the price guarantee assistance package. However, the relatively small amount by which such possible discounted return exceeds that from proceeding with the assistance package must be weighed against the tangible and intangible benefits of concluding the package, particularly when the uncertainties concerning the Government's ability to achieve such a greater return are taken into account.

Thus, DOE and the Administration urge the Board of Directors of SFC approve and execute the price guarantee assistance package agreement with the sponsors as soon as is reasonably possible. There is no administration interest in providing a large Federal subsidy for a brief period of operation. Since the information gained from lengthy operation of the plant is a major National

National benefit from its operation, we believe every effort should be made in negotiating such an agreeement to ensure long-term operation of the plant and maximum additions to the synthetic fuels data base. DOE has concluded, after extensive analysis, that such a package should be adopted as the best choice today for the U.S. taxpayer, the Nation's energy security and the U.S. Government.

Chronology

To show the progress this project has made, I believe a brief chronology of events is in order. Twelve years ago in the spring of 1973 the Synthetic Fuels Group was formed at American Natural Resources. From this beginning group, a series of organizational steps were taken which resulted in the formation of a consortium in June, 1978 known as the Great Plains Gasification Associates (GPGA) consisting of American Natural Resources, Midcon, Columbia Gas, Tenneco and Transco. In 1980 final zoning authority for construction was received from the Mercer County, North Dakota Board of Commissioners and site preparation began in July. By August the final Environmental Impact Statement was completed.

In the spring of 1981, FERC approval was received covering the plant's synthetic natural gas pricing arrangements and construction work began August 14, 1981. In that same month the Department of Energy issued to GPGA a conditional commitment for a loan guarantee.

In January of 1982 the Department of Energy and Great Plains officially signed all documents necessary for the issuance of a federal loan guarantee (LGA) for up to $2.02 billion. That spring Pacific Lighting Corporation of Los Angeles acquired a 10% interest in the partnership and in July the first of the 14 gasifier vessels was installed in the gasifier building.

In March of 1983, because of forecasted natural gas prices lower than expected when the project began, GPGA indicated a projected cash flow shortfall, preventing return of their contributed equity within 10 years as stipulated in the Partners Consent and Agreement. This condition, which still exists, allows the Project sponsors to withdraw from the Project without obligation to repay the loan, although some previous deductions or tax incentives must be reversed or repaid at that time. The partnership filed an application in September of 1983 with the Synthetic Fuels Corporation for price guarantees. The SFC Board authorized in December 1983 a targeted solicitation for coal or lignite gasification projects.

In April of 1984 the SFC Board approved the letter of intent to provide price guarantees. That July, the first SNG produced by Great Plains was sold and shipped to the Northern Border Pipeline. Just four weeks ago, less than four years after construction began, Train B of the plant achieved 72 consecutive hours of operation at rated capacity of 68.75 MMSCF per day. Train A accomplished the same feat four weeks earlier. As with any project of this scope, there have been difficulties, but the bottom line is that the plant was completed under budget and is operating and producing synthetic natural gas, and other products.

The following table shows the monthly plant output, per cent of capacity and per cent of time gas has been delivered into the pipeline for interstate use by consumers since August 1984.

Month	MMSCF Delivered	Ave. Daily Prod. In MMSCF	% Plant Capacity	% of Time In Pipeline
August, 1984	529.1	14.1	10	25
September 1984	539.5	18.0	13	45
October, 1984	1085.5	35.0	25	70
November, 1984	2346.0	78.2	57	95
December, 1984	2883.3	93.0	68	99
January, 1985	2963.2	95.6	70	96
February, 1985	2446.8	87.4	63	92
March, 1985	2620.8	84.5	62	93
April, 1985	3067.0	102.22	74.2	93

Purpose of the Act Which Authorizes the Financing for the Project.

For the purposes of review I also would like to comment on the Act which authorizes the financing for this Project.

Section 207 of Title II of the DOE Act of 1978 (Public Law 95-238) amended the Federal Non-Nuclear Energy Research and Development Act of 1974 (Public Law 93-577) by adding a new Section 19. The purpose of this section was threefold:

- To assure adequate Federal support to foster a demonstration program to produce alternative fuels from coal, oil, shale, biomass and other domestic resources.

- To authorize assistance through loan guarantees for construction and start-up and related costs to demonstration facilities for conversion of domestic resources into alternative fuels.

- To gather information about technological economic, environmental and social costs, benefits and impacts of such demonstration facilities.

The importance of the third purpose, information collection, is significant in the fact that Section 1 directed the DOE to submit to Congress a report, to be updated at least annually, to include: a comprehensive plan and program to acquire information and evaluate the environmental, economic, social and technological impacts of the demonstration program. To carry out the purpose of the Act, the Loan Guarantee Agreement with GPGA contains provisions for facilitating the acquisition of information.

The information gathering aspect of the Project has been an ongoing process under these provisions. The Project has now progressed to a stage where meaningful data is beginning to be available on the operation of this type of facility. The current sponsors of Great Plains are doing a good job of developing and collecting information from the Project that would be useful in the future for similar projects.

We should point out that the five sponsors of Great Plains are major companies of the gas industry and have a vested interest in ensuring that the necessary technical, environmental and other information to be generated by the Project will be collected so they can themselves use it in the future if the economic need arises.

The primary means by which GPGA distributes information on the plant is by submittal of timely, comprehensive monthly, quarterly and annual reports, as well as special study reports to the DOE.

Benefits Derived from Early Development of Synthetic Fuel Plants Such as the Great Plains Coal Gasification Project

The Great Plains Coal Gasification Project in North Dakota will be the Nation's first large scale synthetic fuels plant designed to convert coal into pipeline quality synthetic gas. This first-of-a-kind project has already provided a substantial amount of valuable information, not only in terms of designing, building, and financing a massive coal conversion plant but also in terms of environmental permitting, land and water management, and community planning. However, the true value of Great Plains will not be achieved until the plant is completed and operated.

The importance of the Great Plains Project is more than the addition of a relatively small increment of gas to the Nation's present gas supplies. The project will generate U.S.-based synfuels experience with respect to siting, design, construction, start-up and operations, environmental effects, socioeconomic impacts, and cost related matters that will be of substantial benefit to other potential developers of such projects. Because of the considerable period of time required to construct and begin commercial operation of a coal conversion project (five to seven years), completing the Great Plains project will provide critical timing advantages with respect to the capability of the U.S. to move forward with commercial synthetic fuel conversion on a broad scale should it become necessary to do so.

A major objective of the Great Plains plant is the acquisition of information which will reduce the level of uncertainty associated with future synthetic fuel projects. As uncertainty is reduced and increased "real life" information becomes available to the investor, it is likely that the cost of capital for such projects will be reduced and financing flexibility increased accordingly. At the same time, the experience derived from the Great Plains Project will invariably result in reduced costs, improved performance and better products — all of which will lead to improved synthetic fuels marketability in the future.

Specifically, the Great Plains Project offers the opportunity to acquire essential data in the following areas:

Plant Performance: Information generated through operating a first-of-a-kind facility will be needed to ensure that future synthetic fuel plants can function reliably and at sufficient performance levels to permit sustained commercial operation. There is no absolute way to predetermine how key operational components will perform until they are integrated into an actual working system. The "on-stream" time — or the availability of the system — can only be established through operating an existing plant and if necessary, subsequently modifying or replacing components found limited in lifespan or operating capabilities.

Resolving these issues in an operating pioneer facility such as Great Plains will significantly reduce time, materials, and costs incurred in subsequent commercial capabilities.

Site Related Experience: Although some data exists (principally from the South African SASOL II and III plants) that could be used as a guide in materials selection and use, it is important to recognize that the Great Plains gasification facility is being built at a site much different than locations where currently available information was obtained. Wide seasonal changes in temperature with the potential of high winds, snow and ice will impose a harsh operating climate on plant equipment, particularly fluid transport systems. Data from Great Plains will be essential in specifying construction materials and operating methods for future facilities.

Primary Plant Systems: Much of the information to be generated at Great Plains will be unique; it is not available from any other country or from any other facility. This information takes into account the environments and end-use applications typical of the United States and its markets, industrial requirements, consumer attitudes, and regulatory requirements. Specifically, Great Plains offers the opportunity to obtain information on: —

o Zero Effluent Discharge. The impact of this requirement on facility operation, specification of subsystems, requirements for land, solids disposal, in-stream process flows, costs, etc., has not previously been demonstrated at this scale. The information obtained will be essential for identifying and reducing or eliminating high-risk fugitive emissions.

o Sulfur Removal. An adequate, operable system for removing sulfur to the degree required by environmental regulations in a synfuel facility must be demonstrated. One of the key lessons to be learned from the Great Plains Project will be in the area of sulfur management.

- Waste Water Treatment. The opportunity exists at Great Plains to significantly reduce the cost of equipment and chemicals required to operate waste water treatment systems. The information obtained will permit designers of subsequent facilities to optimize systems for future plants.

- Gasification

  The Lurgi Dry Bottom Gasifiers are the only commercially proven gasifier particularly suited for lignite. However, lignite gasifier experience is minimal. (SASOL uses a bituminous coal.) Refining of gasifier operations will establish design criteria for future plants relative to on-stream factor, steam/oxygen ratio, by-product production and gas production rates. In addition, several of the down-stream process units have never been used on this scale, and all of the process units have never been used together, on an operating system, in this service.

System Integration: Only through the use of the candidate parts of any operating piece of equipment, process system, or control logic can the weak points be determined. The Great Plains plant will provide experience in operating enclosed coal handling facilities; the ability to add or remove spare systems from on-stream to standby and vice versa; and the operability of emergency shut down systems.

Commercial, Environmental, and Socioeconomic Value: The value of the Great Plains plant extends beyond technological information. It also will establish, for the first time at full commercial scale in the U.S., precedents and an experience base in areas such as:

- Costs -- Verification of capital costs, including labor materials, components, and instrumentation. Development of data on operational, maintenance and raw material costs.

- Schedules — Development of schedule data associated with the planning, design/procurement, construction, initial operation and continual operation of the facility.

- Management — Development of information associated with project planning and control, licensing, permitting, regulatory compliance, liability risk and financing terms. Validation of data on tax treatment, technology transfer, and price controls.

- Product Characteristics — Development of data on product quality, product slate capabilities and markets, and by-product utilizations.

- Environment, Health and Safety — Validation of approaches to ecology monitoring, pollutant fate and reclamation; mitigation and control approaches; environmental compliance including air quality, water quality, and solid waste control; establishment of data on public and occupational health and safety including medical surveillance, industrial hygiene, epidemiology and toxicology. Operation of the plant will provide the actual experience and data base required to develop appropriate regulations in the environmental area. Data from this plant will assure that meaningful regulations are established, based upon real performance as opposed to projected as estimated data. This is perhaps the first time such planning has ever been placed on a commercial energy industry in this country. This planning will provide the synfuels industry, as well as the regulators, with a guidance package for future development rather than a package of problems and mistakes based on history. This Project offers a prospective evaluation of the synfuels industry rather than a usual retrospective look.

- Community Impacts -- Validation of socioeconomic impact predictions and infrastructure requirements; impact mitigation process; and requirements for replicating that process.

This information is fundamental if policymakers and regulatory agencies are to make well-informed, prudent decisions in the future regarding synthetic fuel facilities.

Current Status of the Project

From the benefits of the Project let me now move to the current status of Great Plains in three categories: the environment, operating rates and the Project costs to date.

Environment

Environmental activities are on schedule with 48 federal, state and local permits received to ensure compliance with the appropriate regulations. GPGA continually monitors these permits to maintain compliance. The remaining permit to operate is now scheduled for October 1986. To obtain this permit, the plant has to meet all pollution control equipment permitting levels and has to be "In Service". Process and environmental design data are being assembled by DOE, based upon release of non-proprietary technical data by GPGA. GPGA signed two consent agreements with the North Dakota State Department of Health. The first agreement commits GPGA to accomplishing a number of capital projects designed to eliminate odors emanating from the plant. The cost of these capital projects will total $7.4 million. The second agreement specifies the dates on which completion of the compliance testing of pollution control equipment will be accomplished.

On April 16, 1984, the Supplemental Environmental Plan (SEP) agreement was signed, and is being implemented by GPGA. This $12 million program, authorized under the LGA, will provide the public with valuable environmental data over and above that which is required under compliance regulations. The first two programs, a Performance Survey and Ambient Organics Monitoring have been initiated.

Operating Rates

Coal deliveries from the Coteau Properties Company Freedom Mine began on August 15, 1983, to Basin Electric Antelope Valley Station and on March 13, 1984, to the Great Plains Gasification Plant. In the first quarter 1985, 1.5 million tons of lignite have been delivered to GPGA of which 0.5 million tons of coal fines were sold to Basin Electric. These fines (less 1/4" size) cannot be utilized in the Lurgi gasifiers.

Pipeline quality SNG continues to be produced, compressed and transported via the Northern Border Pipeline to market.

Each of the Project sponsors except Pacific Lighting is obligated under the FERC agreement to purchase a portion of the plant's synthetic gas. To date the large quantities of CO_2 produced by the plant have not been sold. Due in part to lower projected oil prices, the expected use of CO_2 in enhanced oil recovery has not occurred. Through the end of March 1985, approximately 15,230 million standard cubic feet of synthetic gas sold for $84.4 million. In the same period, two by-products were recovered and marketed.

(1) 8,700 Tons were sold of ammonia sold for $1.4 million, and
(2) 4,000 Tons were sold of sulfur sold for $0.15 million.

The average daily net SNG production during April 1985 was 102.1 MMSCF with a plant stream factor of 74.2%. On April 30, 1985, an all time record was achieved with a 130.4 MMSCF delivered to the pipeline.

As can be expected during the period of transition between start-up and normal operations, numerous equipment and operational problems were experienced. Although most incidents were of minor nature, they often resulted in significant reductions in SNG sales.

"In-Service Date"

The "In-Service Date" has been defined by DOE and GPGA for purposes of the LGA. The "In-Service Date" will occur on the day the plant has produced gas into the pipeline which meets quality specifications at an average rate of production of 70% of design capacity (96 MMCF per day) for any 90 day period commencing after December 1, 1984, and when each train of the plant shall have produced an average of 68.75 MMCF per day of such gas for a period of 3 consecutive days. Any downtime scheduled for maintenance, modification or replacement of catalysts is to be excluded from the 90-day period and not be included in determining the average daily production. Train A achieved on March 26, 1985 and Train B achieved on April 29, 1985, 72 consecutive hours at 100 percent of rated capacity of 68.75 MMSCF per day.

Under the current LGA, GPGA has the right to draw down guaranteed indebtedness for up to one year after the "In-Service Date", or until June 1, 1987, whichever occurs first. That means that DOE is obligated to permit disbursements for eligible costs including interest costs until possibly June 1, 1987.

Under the proposed SFC price support agreement GPGA would be prohibited from borrowing funds from FFB after the closing date of the price support agreement or the DOE "In-Service Date", whichever occurs later. There is no one-year window for continued borrowing.

Total Project Costs

As of March 31, 1985, the Great Plains Gasification Associates estimate their total project costs to be as follows:

December 1984 Estimate at Completion	$2,065,283,300
Contingency	$ 47,419,700
Total Estimate at Completion	$2,112,703,000
Expended through March 31, 1985	$1,991,347,129
Unexpended/Estimate to Complete	$ 121,355,871

The unexpended balance of Total Project Costs as of March 31, 1985, is expected to be utilized to pay operating costs ($40M) until the plant is declared in-service (mid-June 1985) and costs of ongoing capital projects ($40M). Contingency reserves are still being maintained at $40M.

Financial Outlook for Project under 1983 and 1985 Forecasts

The financial outlook for the Project under current forecasts is illustrated in the charts under Attachment A, "Comparison of SNG Revenue Forecasts". The 1985

NEPP revenue forecast, without SFC assistance, projects a substantially lower revenue outlook when compared to the 1983 NEPP IV projections. We have then converted these revenue forecasts to earnings and after-tax cash flow, summarized in the two charts in Attachment B, "GPGA Comparative Analysis of Cumulative Parent Net Book Income" and "GPGA Comparative Analysis of Cumulative Parent After-Tax Cash Flows". The key points to note from these analyses are:

Significant parent book losses from operations - The parents cumulative net book losses for the first five years of operation, from 1985 - 1989, are approximately $480 Million: The parents book losses for the first ten years, 1985 - 1994, are currently projected at $830 Million.

Significant additional tax liability to abandon - The cost to the parents in additional tax liability to abandon significantly increases over the near term. However, based on calculations made by SFC at the request of the Office of Management and Budget (OMB), the resulting net income loss to the parents would be less in 1988 if they operated the Project until then without SFC assistance and then abandoned, than by immediate abandonment.

Deteriorating after-tax cash flow - The parents after-tax cash flow without price support assistance is positive for the initial period 1985-1988, primarily due to large tax benefits. After that time, the after-tax cash flow turns negative and becomes increasingly so. For example, the operating period 1985 - 1994 cash flow would be a negative $660 Million. This means that the partners would need $660 Million to continue participation in the Project for the next ten years to meet loan obligations.

Furthermore, the Project sponsors have informed SFC and DOE officials as well as others that after 18 months of negotiations with the SFC for a price support agreement, which has now been negotiated, they will not continue to participate in the Project if such agreement is not concluded very soon.

What does DOE do if GPGA Withdraws from the Project

There are two basic choices for DOE, subject to availability of funds, if the sponsors withdraw from the Project: (A) try to operate the Project as a GOCO; or (B) try to sell the Project. If neither is chosen or successful, the Project could be scrapped. Scrapping this Project will not generate enough funds to pay off the FFB loan and will terminate any further information collection efforts. Thus, scrapping is a last resort choice.

Regardless of which choice is selected, the Government will have to eventually take title to the property. This will require one of two possible actions:

(1) Foreclosure after default; or
(2) Sale, for some agreed price by GPGA to DOE.

1. Foreclosure after default is a legal procedure and there are several complications with respect to North Dakota law. It is estimated that a foreclosure would require a minimum of 120 days to the point of execution. In addition, GPGA would be entitled to a one-year redemption period and would be entitled to possession of the real property, and to the profits thereof, during that time. It is important to note that although GPGA might voluntarily waive these rights, under North Dakota law, all contracts in restraint of the right of redemption are void and unenforceable. The cost of redemption by GPGA during that year would be the amount of (a) the

outstanding debt and interest and associated costs, and (b) the cost of any necessary improvements made by the DOE after foreclosure. It should be kept in mind that there are up to $100 million of improvements scheduled for implementation at this time. These are required to allow the Project to achieve scheduled production rates and meet environmental requirements.

2. Sale of the Project for Some Price by GPGA to DOE
A direct transfer of title, from GPGA to DOE would end GPGA's participation in the Project, the same as termination, but would satisfy DOE's requirement for a timely settlement. This could be accomplished before or after termination, with advantages accruing to both parties. A critical aspect of this alternative is the continuation of contracts currently outstanding. A smooth transition of control would necessitate assignment of all contracts to which GPGA is a party. The advantage to the Government, of course, is the elimination of the foreclosure procedure. The consideration to the GPGA partners would have to be negotiated.

Once title is obtained, DOE may then contract with an operating contractor that is acceptable to the licensors for any length of time desired. A sale of the plant could then be contemplated if conditions should warrant such an action in the future.

As stated above there are two basic choices for DOE if the sponsors withdraw from the Project. These choices are now discussed.

(A) GOCO - Government Owned - Contractor Operated
Under this choice the Government must take title to the property and will then operate it, through use of operating contractors, for the benefit of

the Government. It should be emphasized, however, that none of the alternative courses of action discussed under this GOCO section can be implemented because DOE has no funds to do so. DOE would have to request an appropriation, and possibly new statutory authority, from Congress. Insofar as obtaining an operating contractor, the DOE has several legal options:

(1) Exercise the option under the LGA to take possession of the current operation through a stock transfer. Currently ANG Coal Gasification Company (ANG) is under contract with GPGA to construct, complete start-up and operate the Project. The stock of ANG was pledged as collateral to the Department in consideration for the LGA. In the event of a default by GPGA, all of the stock of ANG could transfer to DOE. This would make ANG a company wholly owned by the U.S. Government.

(2) Do not exercise the stock transfer option with respect to ANG, but require ANG to continue as Project Administrator as allowed by the LGA (contract assignment provision). Under the terms of the ANG Agreement, exercise of this option obligates the DOE to pay or reimburse ANG for its actual costs thereafter. The agreement provides that ANG will continue "pursuant to an agreement substantially in the form of the Project Administration Agreement." It appears that the DOE could convert this agreement into a letter contract with minimal changes. Justification for non-competitive procurement would be required. In any case, this is an interim measure intended to meet immediate needs, while further decisions are being made and implemented.

(3) Competitively procure the services of an operating contractor. Obviously, this procurement action would take considerable time and thus option (2) above would be exercised in any event to try to reduce the likelihood of an interruption of operation.

Regardless of the legal option chosen no guarantee can be made that the plant will not have to be shut down for an extended period. The legal ramifications of such options have not as yet been clearly defined. The operational issues such as whether the current employees would be willing to become Federal Government employees or would stay employees of ANC during the period of uncertainty have also not been determined. In any event, the voluntary quit rate by the employees is likely to rise significantly as the employees seek and/or find more secure employment elsewhere.

(B) Sale

Sale of the facility can only be achieved after title is transferred as noted above. It appears obvious that a sale could not be accomplished in less than one year. The alternatives available under this restriction are to either (1) shut down operations until a sale is consummated, or (2) try to operate as a GOCO until a sale is consummated.

It has been estimated that the plant can be maintained for up to three (3) months without serious deterioration of equipment, in a non-operating mode. The estimated cost for routine security and maintenance is approximately \$1.5 million per month. This assumes carrying only a core of operating personnel (50) and maintenance (30) and security (20) forces. Obviously, there will be significant problems in the restart due to need to hire or rehire and maybe train or retrain over 800 personnel. There will be costly start-up problems and inefficiencies.

If the plant is to be shut down for over three months, it will begin to suffer physical deterioration. This obviously will lower the resale value. The plant is more valuable as an operating entity.
Costs to put the plant back into operating shape may be prohibitive. Therefore, it might be necessary to mothball the facility. It is estimated that mothballing would cost $100 million. Maintenance costs thereafter would be about $500,000/month and restart would be another $100 million. There would also be the economic penalties for hiring, loss of experience, and inflation costs.

Therefore, it would appear that if a sale (other than for scrap) is contemplated, it would be advantageous to try to operate the plant as opposed to shutting it down. However, the availability of funds to do this is not certain since DOE does not have funds authorized and appropriated to do this.

DOE Analyses of the Price Support Assistance Agreement
DOE has performed extensive analyses regarding the impact of the negotiated price support agreement between the SFC and Great Plains sponsors. This analysis considered all cash flows (from July 1985 through December 2009) to the Government on a comparative basis. The table entitled, "Summary of Net Cash Flow to the Government" sets forth the cash flows to the Government as a result of five options and is found in Attachment C.

Two Key Options: Price Supports or Immediate Abandonment
The two most prominent options to consider are: II- With SFC Price Support Abandonment - 1989, and V - Immediate Abandonment and Sale. Proceeding with the price support agreement and assuming an abandonment in 1989, is slightly less

financially attractive on a discounted cash flow basis to the Government than allowing an immediate abandonment and sale of the Project. However, when the substantial uncertainties regarding the price at which a third party might purchase the Project are taken into account, the net effect from the facility sale could be reduced to zero. This would make the price support option much more attractive on a discounted cash flow basis to the Government than the immediate abandonment case. Because payments received by the Government in the future are much less valuable and more uncertain than payments received earlier, the discounted cash flows are more important in evaluating the options than the undiscounted cash flows.

	Option II 1/ With SFC Support; Abandonment in 1989 ($ in Millions)		Option V 6/ Immediate Abandonment and Sale ($ in Millions)	
	(a) Discounted	(b)Undiscounted	Discounted	Undiscounted
Cash Effects of Abandonment	$253.5 2/	$371.2 2/	$249.4 7/	$249.4 7/
Great Plains Operation	165.9 3/	186.8 3/	-	-
Net Effect of Facility Sale	- 4/	- 4/	251.1 8/	1689.5 8/
GOCO Operation	- 5/	- 5/	(38.4)9/	(38.7)9/
Net Cash Flow to the Government	$419.4	$558.0	$462.1	$1900.2
Additional impact: Loan Writeoff	$561.5	$822.1	$1,500.0	$1,500.0

Footnotes:

(a) discounted amounts represent the Net Present value of the current year dollar stream discounted at a 10% discount rate to 1985; and

(b) undiscounted amounts represent the current year dollar stream.

1/ Option II with SFC price supports and abandonment in 1989, assumes the price support agreement begins by July 1985 but that abandonment occurs at the end of 1989 and evaluates whether to operate the plant as a GOCO for one year while it is in the process of selling the Project to a third party. (The value to the Government of this option increases if the assumed abandonment is postponed.) In calculating the value of this option to the Government, the items discussed in footnotes 2, 3, 4, and 5 were considered.

2/ Cash Effects of Abandonment

If the Great Plains partners were to abandon in 1989, their additional tax liability due to abandonment would be $371.2M. The discounted value of $371.2M is $253.5M in 1985.

3/ Great Plains Operations 1985-1989

We have calculated the net cash flows to the Government from July 1985 through December 1989 as a result of the Great Plains operation of the facility. The Government net cash flows during this period are $186.8M, with a discounted value of $165.9 million. Elements included in calculating these Government cash flows (both to and from all elements of the U.S. Government) represented the SFC price support payments, the principal and interest repayments, and the Project related net Federal Government tax benefits or payments by the Project sponsors.

4/ Net Effect of Facility Sale

We also attempted to calculate a sale price for the facility in 1990, based upon the National Energy Policy Plan V (NEPP-V) preliminary mid-range gas prices and assuming that the purchaser would require a 30% investor rate of return (IRR) at a 1:1 debt/equity ratio over a period of 10 years. These conditions are believed to reflect the view a perspective buyer would have of the financial/business riskiness of this Project. A new investor in this Project will almost certainly have a much higher profitability and cash flow standard than the existing sponsors. Based upon the defined conditions, the plant was not saleable; therefore, no value was assigned. This understates the cash flow to the Government by omitting any proceeds from a sale of the plant for scrap value.

In addition, we applied the conservative assumption that a purchaser of the facility after January 1, 1990, would not be eligible for the Production Tax Credit. It is unclear whether the "placed in service" test relates to the Project or the purchaser. If the purchaser were eligible for PTC, the plant is saleable in 1990. The effect of the sale would be an additional $277.7M of discounted Government cash flows to this scenario.

5/ GOCO Operations 1990

We initially assumed the Government would operate the facility as a GOCO during the sale period. Since no ensuing sale would occur and a negative cash flow would result from a GOCO operation in this year, we assumed no GOCO operation would occur and, therefore, no value was assigned.

In addition, we applied the conservative assumption that a purchaser of the facility after January 1, 1990, would not be eligible for the Production Tax Credit. It is unclear whether the "placed in service" test relates to the Project or the purchaser. If the purchaser were eligible for PTC, the plant is saleable in 1990. The effect of the sale would be an additional $277.7 million of discounted Government cash flows to this option.

The effective value of this Option II to the Government would be $558M on an undiscounted basis and discounted value of $419.4M . These amounts effectively represent the value of the cash flows to and from the Government.

Another factor to be considered would be the loan write-off, which would occur in 1989. The amount of FFB's loan outstanding would then be $822M. An appropriation of $150M would be necessary, in addition to the $670M reserved under the Non-Nuclear Act, to repay the Guaranteed Indebtedness if the sponsors withdraw at that time. We have not included this impact in calculating the cash flow to or from the Government since this does not represent a cash transaction between the Government and the Project or its sponsors.

6/ Option V, Immediate Abandonment and Sale, assumes no price supports are provided and the Great Plains partners abandon the Project and the Government tries to sell the Project thereafter. In calculating the value of this option to the Government, the items were discussed in Footnotes 7, 8, and 9.

7/ Cash Effects of Abandonment

If Great Plains were to abandon today, the real tax liability that they would incur would be $249.4M. This would also equal the discounted value since the cash payment actually is in 1985$.

8/ Net Effect of Facility Sale

We have calculated (using the same approach as in Footnote 4) a sale price for the facility in 1986 and calculated a subsequent tax impact to the Government from the subsequent purchaser. The net effect of the facility sale would be $1,689.5M in undiscounted dollars with a discounted value of $251.1M. The sale price in 1986 is $266.0M, with subsequent tax benefits accrued to the new purchaser until 1996 and then tax payments are made through 2009. The undiscounted dollars (to be received by the Government in this option) are greatly influenced by significant tax payments from 1996 through 2009.

9/ GOCO Operations - 7/85 - 12/86

We assume the Government would operate the facility as a GOCO during the initial 18 month period. It is assumed it would take a year to sell the facility and that the most cost effective alternative would be to run the facility as a GOCO operation until it is sold. However, DOE would need $38.7M to operate the facility during this period since DOE does not have funds to operate the facility.

Another factor to be considered would be the loan write-off which would occur. $1.5 billion is the estimated amount of FFB's outstanding loan and interest on July 1, 1985 when the sponsors are assumed to withdraw from the Project. An appropriation of $930M would be necessary, in addition to the $670M reserves under the Non-Nuclear Act for DOE to repay the Guaranteed Indebtedness to FFB. This amount is not included in calculating the impact of our options since it does not represent a cash transaction.

In addition, the Department has analyzed these two options applying a conservative assumption (with which the Department does not agree) that the gas purchase agreement is not enforceable if the sponsors withdraw from the Project and the Project is sold to a third party. This significantly reduces the revenues of the Project for a third party and it makes the Project not saleable to third party. In this analysis, the discounted and undiscounted cash flows to the Government in Option II of $419M and $558M respectively, are much more favorable than the comparable cash flows of $249.4M and 249.M for Option V.

Based on this analysis, the of price supports, Option II, when compared to an immediate abandonment, Option V, provides a greater cash flow to the Government on a discounted basis and is thus more attractive. Under this assumption, the plant is not saleable in either option. The proposed price support agreement was designed to increase the likelihood of continued participation by the Project sponsors through 1989.

If a further discounting process is used, whereby inflation is removed before discounting, the price support Option II still appears to be the most attractive option on a cash flow to Government basis when the uncertainties involved with a sale are taken into account. (See Attachment C.)

Budget Deficit — Impacts of the Alternatives

The cash flows between the U.S. Government and the Great Plains project have direct and indirect effects on the Federal budget.

FFB loan disbursements, the proposed SFC price guarantee payments and tax benefits to the Project result in direct Federal outlays, while repayments of principal and interest, proposed future profit sharing payments from the sponsor to SFC and sponsor tax payments result in direct collections (negative outlays) to the Government.

In addition to these direct budget impacts, there are indirect impacts resulting from increased Federal borrowing requirements to support the FFB loan, tax benefits and SFC price supports. If it is assumed that the direct payments from the Government to the sponsors are payments on the public debt that are financed through increased public debt, then there are interest payments on the public debt that are attributable to the Government's involvement in this project.

Interest on the public debt is normally not explicitly attributed to the cost of individual Government programs. It is an important indirect cost, however, particularly when considering that the interest on the public debt now accounts for 15 percent of total Government outlays.

Based on the data and analysis developed by DOE, as well as similar work performed on request by the staff of the SFC, the Office of Management and Budget has developed estimates of the cumulative five-year deficit impacts of the various alternatives under consideration. These estimates, presented for both the direct and indirect effects, are shown in the table below.

TABLE
FIVE-YEAR CUMULATIVE BUDGET DEFICIT IMPACTS: MID 1985-1990
INCREASE/(DECREASE)
($ Current in Millions)

	Direct Impacts			Direct and Indirect Impacts		
Case	SFC [1]	GPGA [2]	DOE [3]	SFC	GPGA	DOE
I	(208)	46	(106)	1,390	1,380	1,296
II*	(387)	(259)	(475)	969	1,179	913
III	(779)	(499)	(758)	618	935	617
IV	N/A	N/A	N/A	N/A	N/A	N/A
V	(405)	(333)	(269)	803	977	1,011

[1] Based on energy price and other assumptions developed by SFC staff.

[2] Based on energy price and other assumptions developed by the Great Plains Gasification Associates (GPGA). GPGA cases project that resale on abandonment would be impossible.

[3] Based on energy price and other assumptions used by DOE.

* Termination in 1990, rather than 1989, as assumed elsewhere in this analysis.

N/A Not available.

These estimates of "Direct and Indirect Impacts" portray the total Federal budget impact resulting from the project, including both on-budget and so-called off-budget accounts. (The FFB is currently considered an off-budget entity although the Administration has proposed that it be put "on-budget" in 1986.) Differences in the estimates reflect differences in the basic assumptions adopted by SFC, GPGA and DOE.

The major reason for the substantial difference in the estimates between the direct and indirect effects is the budgetary effect of the FFB loan. Under the direct and indirect effects estimates, the FFB loan, which was disbursed in prior years, is a sunk cost not affecting mid 1985-1990 outlays. However, the estimates for indirect effects include interest payments to the public on the borrowing used to finance the loan disbursements prior to this time.

Recent Developments

Subsequent to the preparation of this analysis, it has come to our attention that the Great Plains Partners have changed their revenue forecast by eliminating CO_2 revenues and changing escalation rates. While this reduction in revenues would make the economies of long-term operation less attractive, the relative position of each option's financial outcome would be unchanged.

Other Options

SFC staff believe that the price support agreement will result in the sponsors remaining involved in the Project beyond 1989 and until after the year 2000. This is because the agreement results in a much lower debt obligation for the Project by the end of the period of price support assistance, and because of higher revenue forecasts than GPGA. In such event, the Government is clearly much better off from a cash flow basis than if there were an immediate abandonment (Option V) or, as in Option II, the sponsors withdraw in 1989. We focused on Option II as a more conservative option for analysis, but evaluated the price support agreement with a "no abandonment" option and other intermediate options as well. For further details of net cash flows to the Government and additional options, see Attachment C.

In Attachment D we have presented for several of the options Schematic Drawings of the Flow of Funds between (a) the various parts of the Federal Government including SFC, DOE and the Treasury Department after all FFB loan disbursements have been made and (b) the GPGA, the partners of GPGA and a third party, if the Project is sold to a third party. These drawings depict the diversity of parties and funds flow that must be considered to understand the cash flow impact on the entire U.S. Government of the various options.

Questions to be Considered and Evaluations to be Made Regarding Costs to Government in Evaluating Projects or Incentive Programs

In the course of evaluating the proposed price support agreement, a series of questions and evaluations have been undertaken which should be considered before SFC, DOE, or other agencies of government as well as Congress proceed with providing financial support to any particular project or to develop any financial support mechanism.

These questions are designed to identify and evaluate all the various existing Federal Government financial incentives and disincentives for such project or proposed program. As the analysis of the Great Plains Project indicates, there are extensive forms of federal financial incentives and disincentives to proceeding with a synfuels project even without consideration of price supports from SFC or a loan from the Federal Financing Bank at less than market interest rates. In the Great Plains case, these other incentives and disincentives include the energy tax credits, investment tax credits, production tax credits, accelerated depreciation, taxes payable if capital assets are not used for minimum period of time, taxes payable in the event of a forgiveness of debt and others. The effect of these various incentives is to provide a significant U.S. Government contribution to the project or program as the case may be. In the case of Great Plains, the loan from the Federal Financing Bank and the prospective price supports from SFC are forms of assistance in addition to the substantial forms of assistance already received by projects of this type. The amount of such federal financial incentives and disincentives should be determined under a range of possible economic scenarios affecting the project or program.

Furthermore, the year-by-year Government budget impact, positive or negative, as well as the cash flow impact on the Government should be determined for any such project or program under a range of economic scenarios.

Only after such an evaluation is made can an informed comparison be made of the benefits to the Government, the taxpayer and the Nation of such project or program. It is quite possible that if such a comparison under a wide range of scenarios had been done in 1980 or 1981, the difficult choices faced today might have been avoided and/or that the Great Plains Project would have been modified to balance differently the total possible costs to the Government versus the total possible gains to the Government.

Evaluation of Alternatives

There are essentially five potential options involving Great Plains Project (see Attachment C) and four major considerations in evaluating which of those options is the most attractive to the Nation. The options are: The cash flow on the Government of the two major options presented above, while the cash flow impacts of the remaining three options are listed in Attachment C. The Options are:

(I) to proceed with the price guarantee assistance package and assume there will be no termination of the Project in the future;

(II) to proceed with the price guarantee assistance package and to assume there will be a termination of the Project in 1989 by which time most of the informational benefits of the Project will have been obtained;

(III) not to proceed with the price guarantee assistance package and to assume that the sponsors will continue with the Project until 1988 and then abandon after which the Government will operate for one year and then sell the Project;

(IV) not to proceed with the price guarantee assistance package and to assume that the sponsors abandon the Project and that the Government operates the Project as a GOCO;

(V) not to proceed with the price guarantee assistance package and to assume that the sponsors abandon the Project but that the Government is able to sell the Project to a third party which operates the Project thereafter.

The four major considerations which must be applied to each of the alternatives are as follows:

1. Financial

   What is the most attractive alternative from the standpoint of cash flow into and out of the Federal Government between the sponsors of the Project, the Project itself and any third party which might purchase the Project. This must be considered under various financial assumptions about projected price scenarios for natural gas; the willingness of a third party to purchase the Project, and under what conditions; and the likelihood of the incentive pricing agreement approved by FERC continuing if the current sponsors of the Project are no longer involved. With respect to the sale of the Project to any third party, one must consider whether such party will be able to retain the benefit of the FERC-approved contract for sale of GPGA gas (since the former sponsors will have a motivation to try to withdraw from that binding contract in order to purchase cheaper natural gas elsewhere.

2. Operational/Managerial

   The issues to be considered include the advisability of the Government to operate and manage a project like this; the desire reflected in the synfuels statutes that the synfuel projects involve the private sector because it will be the ultimate user of the knowledge derived from projects like Great Plains. With respect to a sale to a third party, evaluation needs to be performed as to whether the third party will be able to collect and disseminate the technical/environmental information derived from the Project as effectively as have the existing sponsors. Will such party have an even greater profitability requirement and/or a more pessimistic view of Project revenues than has been used in the analysis. This could have the effect of reducing the price the party would pay the DOE for the Project to such a low "fire sale" price that Congress or other reviewers will contend the price is "too low" and urge the Government to operate the Project itself. The amount of time it will take during a procurement process to select the purchaser of the Project is also significant, since there will also be problems for the Government during any interim period before a third party can purchase the plant. Such problems include retaining the skilled employees to operate the plant for the Government during the uncertain interim period, obtaining funds from Congress to permit such plant operation, and waiting until expiration of a one year period permitted by the North Dakota law for a debtor to reacquire possession of its former asset by repaying its debt, so that any purchaser can obtain clear title to the Project. Finally, the Government will have to begin to deal with a different, private party on a major complicated Project."

3. Technical/Environmental Information Collection and Value of such Synfuels Related Information to the Nation

The extent and potential use of such information is described above starting on page 8. There are benefits to the Nation of developing, collecting and disseminating technical/environmental and socioeconomic information from synfuels projects like Great Plains. Such benefits could be substantial. The current sponsors of Great Plains are doing a good job of developing and collecting information from the Project that would be useful in the future for other similar projects.

If the current sponsors withdraw from the Project, there will be an inevitable disruption in the Project and could result in a loss of continuity of existing systems and procedures for collection, reporting and dissimination of data. Furthermore, the Supplemental Environmental Plan Agreement valued at $12 million would be in jeopardy under any new arrangement.

The current licensing agreements involving proprietary equipment and processes will need to be renegotiated with third parties acceptable to the licensors if the current sponsors withdraw from the Project. This requirement would place restrictions on future contractors responding to a sale or competitive procurement to operate the plant.

There is an advantage to the Nation of continuing the Project at least until 1988 or 1989, by which time almost all of the most important value of the Project will have been obtained.

4. Reliability of Government

Since December 1983 when the SFC Board authorized a solicitation for a coal gasification project, which only Great Plains could realistically respond to, there has been an expectation by the sponsors of Great Plains, the Department of Energy and others that SFC would negotiate a price support agreement of some amount with the sponsors of the Great Plains Project. In return for that non-binding commitment by SFC, the sponsors of Great Plains continued with the Project and invested $124.5 million additional equity in it, while DOE approved $499 million additional borrowings by the Project from the Federal Financing Bank. Since the latter of intent was executed in

> April 1984, the sponsors have invested $78.6 million in equity in Great Plains and the FBB has loaned $332.5 million to the Project. There is no binding legal commitment by the SFC to enter into a price support agreement with Great Plains. However, if the price support agreement is not now concluded by the SFC and the Great Plains sponsors after the months of negotiation, some would argue that the Government is not a reliable partner for extensive projects. Evaluation of the five options in light of these considerations results in elimination of all except proceeding with the price guarantee assistance package.

Option IV, which would result in the GOCO operation of Great Plains, is not desirable for the managerial and information considerations mentioned above. The only time that the Government is best suited to operate in the marketplace is where it sets the requirements and is the sole user of the product or services. This is not the case with synfuels. Further, the entire $1.46 Billion loan would have to be written off. DOE would have to seek an appropriation to pay off the FFB. Operation as a GOCO requires going through the legal procedure of taking title to the property and then finding an appropriate operator. This is a time-consuming and disruptive exercise which could have a costly impact on continued operation of facility. Once operating, the Government then would be in a position of competing with private sources of energy. The question remains as to the willingness of the current sponsors to honor the current FERC agreement.

In addition, moreover, to seeking the appropriations necessary to pay off the FFB, DOE would also have to seek appropriations to operate the GOCO for possibly an indefinite period of time. Further, DOE would have to determine whether authorizing legislation is available, and if not, would have to seek new legislation with the resulting need to propose and finalize implementing regulations. Finally, the Federal Government as a policy matter ought not to be making decisions which would unnecessarily increase Government competition with private industry.

Option III, (no price supports and assumed continuation by the sponsors) would result in favorable economies to the sponsors through 1988 — positive after-tax cash flow and lower abandonment costs (in present value terms) than immediate abandonment. And, operation of the Project through 1988 would allow the Government and the public to gain important information benefits. However, continuation of the Project by the sponsors would result in recurring income statement losses. Thus, on balance, DOE believes that Option III is not realistic because the sponsors of Great Plains have essentially advised DOE, SFC and others that they will not continue with the Project without such price support assistance. In other words, they threatened to withdraw from the Project if the price support agreement is not concluded very soon.

Option V, which would result in no price supports but an attempt by the Government to sell the plant to a third party, could potentially result in the largest financial and budgetary return to the Government, depending upon several critical assumptions. However, the financial returns are not substantially greater than Options I and II. Moreover, Option III is not desirable for operational, and reliability of Government considerations. If a sale could be successfully arranged, the information benefits of the Project would be preserved, but there are a number of risks and uncertainties in the sales process, as discussed earlier.

In summary, Options I and II, namely to proceed with the price guarantee assistance agreement with the Great Plains Project, are more attractive than each of the other options for operational, information, and reliability of Government reasons because they do not disrupt status quo. Options I and II do provide a positive financial return to the U.S. Government and minimize the likelihood that the sponsors would abandon the project prior to obtaining the full information benefits.

Conclusion and Recommendation

If the sponsors of Great Plains withdraw from the Project for whatever reason, DOE will require additional appropriated funds to pay off the FFB loan of $1.46 billion and to cover any attempt to operate the plant pending its ultimate disposition. Since the purpose of such funds would be related to synfuels, DOE would almost certainly request Congress to allocate and appropriate to DOE from SFC the existing appropriations of such funds as are required to pay off the FFB and/or to operate the plant. In summary and conclusion, the Department of Energy and the Administration, after analyzing the price guarantee assistance package negotiated between the sponsors of the Great Plains Project and the SFC staff, have concluded that such package agreement should be adopted as being the most reasonable course of action among the choices available regarding this Project at this time. We are not opposed to a price support agreement. Indeed, we believe it may well be appropriate in this case. However, there is no administration interest in providing a large Federal subsidy for a brief period of operation. Since the information gained from lengthy operation of the plant is a major National benefit from its operation, we believe every effort should be made in negotiating such an agreement to ensure long-term operation of the plant and maximum additions to the synthetic fuels data base. Thus, the Department of Energy and the Administration urge the Board of Directors of SFC to approve and execute an appropriate price guarantee assistance agreement with the sponsors of GPGA as soon as reasonably possible.

LIST OF ATTACHMENTS

A. GPGA Comparison of SNG Revenue Forecasts

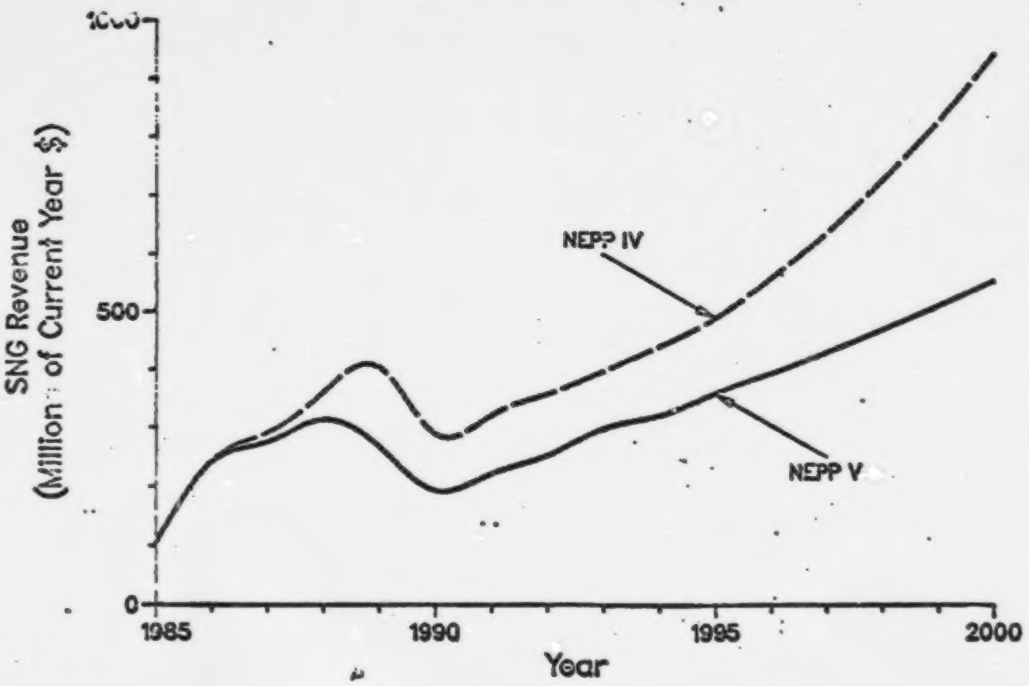
B. 1) GPGA Comparative Analysis of Cumulative Parent Net Book Income; and

   2) GPGA Comparative Analysis of Cumulative Parent After-Tax Cash Flows

C. Great Plains Analysis - Summary of Net Cash Flows to the Government

D. Schematic Drawings, Flow of Funds

Great Plains Gasification Project
Comparison of SNG Revenue Forecasts



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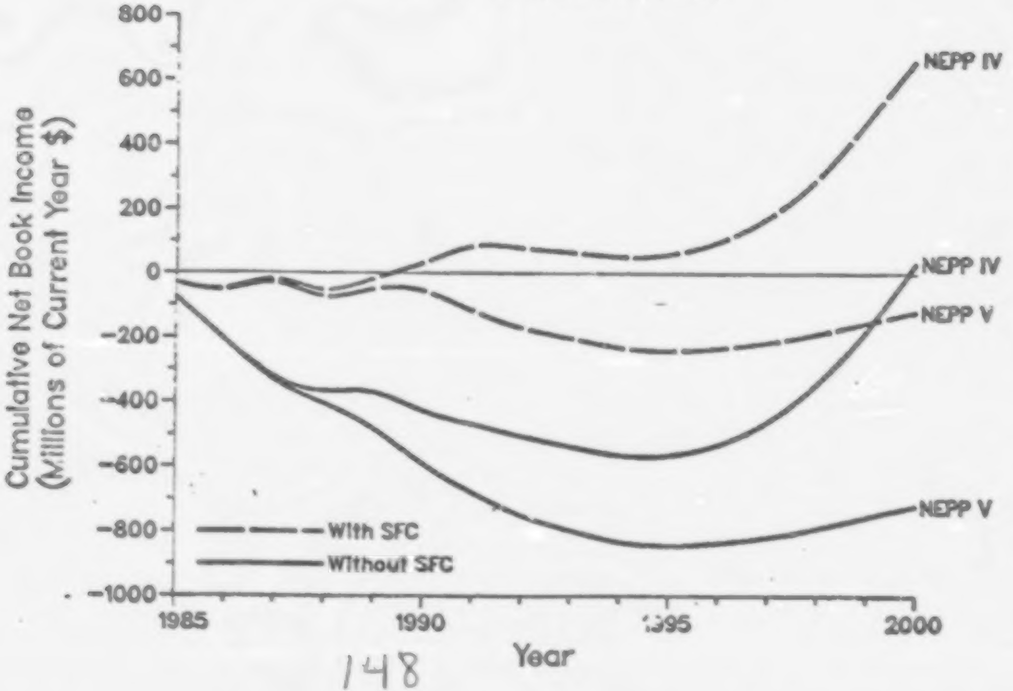
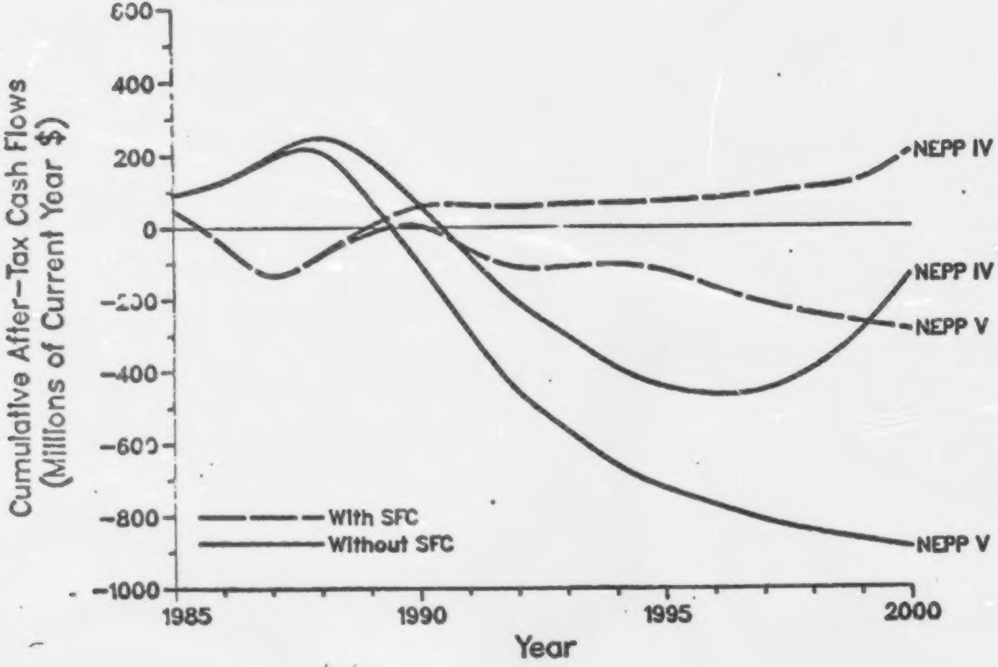
Great Plains Gasification Project
Comparative Analysis of Cumulative
Parent Net Book Income



Great Plains Gasification Project Comparative Analysis of Cumulative Parent After-Tax Cash Flows



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GREAT PLAINS ANALYSIS
SUMMARY OF NET CASH FLOWS TO THE GOVERNMENT
($ IN MILLIONS)

		Net Cash Flows		Additional Impact
		Discounted	Undiscounted	Loan Write-Off
I.	SFC Price Support Assistance with no Termination of the Project	$ 764.9	$3,624.4	-0-
II.	SFC Price Support Assistance with Termination of the Project in 1989	$ 419.4	$ 358.0	($ 822.1)
III.	No Price Support Assistance with Abandonment in 1988; GOCO Operation 1989; Sale on 1/1990	$ 713.9	$2,401.6	($ 1,443.3)
IV.	No Price Support Assistance with the Sponsors Immediately Abandoning the Project. GOCO Operation Thereafter.	$ 930.1	$4,578.4	($ 1,500.0)
V.	No Price Support Assistance with Sponsors Immediately Abandoning the Project. Government Sale of Facility to Third Party.	$ 462.1	$1,900.2	($ 1,500.0)

Note:

Discounted amounts represent the Net Present of the current year dollar stream discounted at a 10% discount rate to 1983.

Undiscounted amounts represent the current year dollar stream.

Description of Scenarios:

I. SFC Price Support Assistance with no Termination of the Project – to proceed with the price guarantee assistance package and assume there will be no termination of the Project in the future.

II. SFC Price Support Assistance with Termination of the Project in 1989 – to proceed with the price guarantee assistance package and to assume there will be a termination of the Project in 1989 by which time most of the informational benefits of the Project will have been obtained.

III. No Price Support Assistance with Abandonment in 1988; GOCO Operation 1989; Sale on 1/1990 – no price support assistance provided to current sponsors with the sponsors continuing with the Project until 1988. An abandonment at the end of 1988 with a GOCO operation in 1989 and a sale effective 1/1990. This is an unrealistic scenario because the Great Plains partners are not expected to continue participation in the project without prior support assistance from SFC.

IV. No Price Support Assistance with the Sponsors Immediately Abandoning the Project. GOCO Operation Thereafter – no to proceed with the price guarantee assistance package and to assume that the sponsors abandon the Project and that the Government operates the Project as a GOCO project.

V. No Price Support Assistance with Sponsors Immediately Abandoning the Project. Government Sale of Facility to Third Party – not to proceed with the price guarantee assistance package and to assume that the sponsors abandon the Project, but that the Government is able to sell the Project to a third party which operates the Project thereafter.

GREAT PLAINS ANALYSIS
SUPPLEMENT TO SUMMARY OF NET CASH FLOWS TO THE GOVERNMENT
RESULTS CALCULATED IN 1985 $'s
($ IN MILLIONS)

	Inflation Adjusted	
	Discounted	Undiscounted
I. SFC Price Support Assistance with no Termination of the Project.	$ 410.8	$ 1,359.3
II. SFC Price Support Assistance with Termination of the Project in 1989.	$ 364.3	$ 481.3
V. No Price Support Assistance with Sponsors Immediately Abandoning the Project. Government Sale of Facility to this Party.	$ 343.2	$ 815.5

This is a supplemental analysis which removes inflation from our table "Summary of Net Cash Flows to the Government ($ in Millions)."

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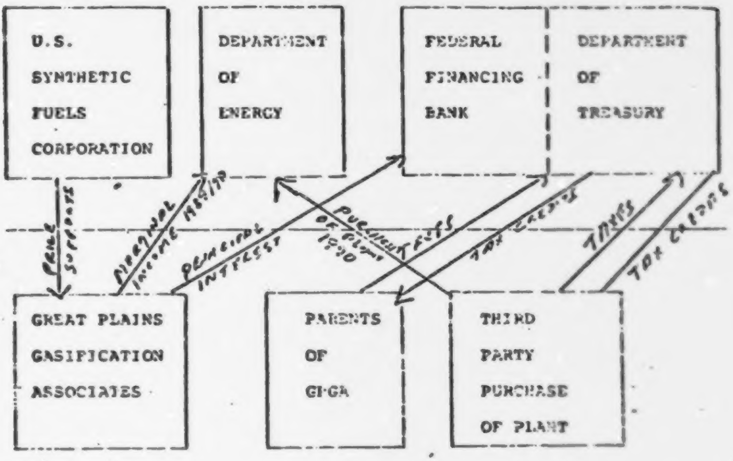
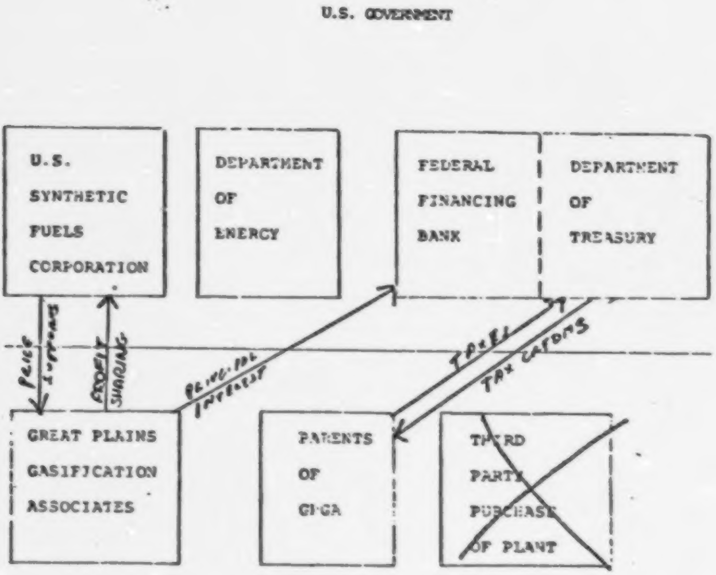
OPTION II: with price supports - abandonment, 1989; sale in 1990

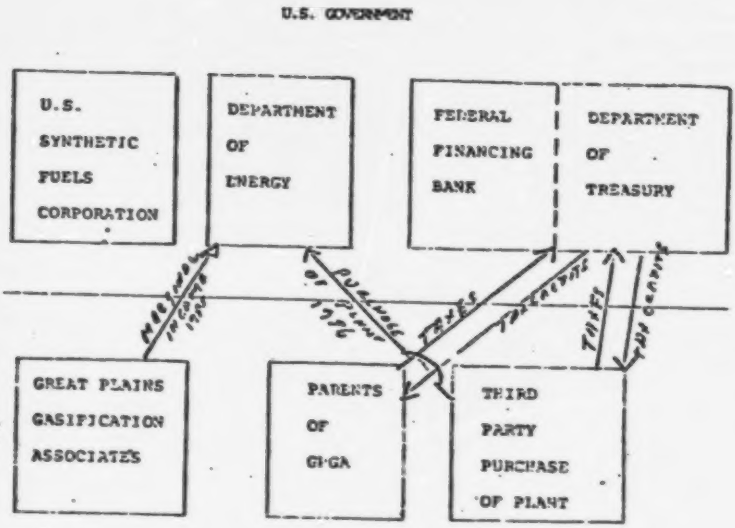
U.S. GOVERNMENT


U.S. SYNTHETIC FUELS CORPORATION
DEPARTMENT OF ENERGY
FEDERAL FINANCING BANK
DEPARTMENT OF TREASURY
PRICE SUPPORTS
MARGINAL INCOME 1989/90
PRINCIPAL INTEREST
PURCHASE OF PLANT 1990
FEES
TAX CREDITS
TAXES
TAX CREDITS
GREAT PLAINS GASIFICATION ASSOCIATES
PARENTS OF GPGA
THIRD PARTY PURCHASE OF PLANT

OPTION I: with SFC price supports - no abandonment


U.S. GOVERNMENT
U.S. SYNTHETIC FUELS CORPORATION
DEPARTMENT OF ENERGY
FEDERAL FINANCING BANK
DEPARTMENT OF TREASURY
PRICE SUPPORT
PROFIT SHARING
PRINCIPAL INTEREST
TAXES
TAX CREDITS
GREAT PLAINS GASIFICATION ASSOCIATES
PARENTS OF GPGA
THIRD PARTY PURCHASE OF PLANT

OPTION III: No price supports - abandonment, 1988; sale in 1990


U.S. GOVERNMENT
U.S. SYNTHETIC FUELS CORPORATION
DEPARTMENT OF ENERGY
FEDERAL FINANCING BANK
DEPARTMENT OF TREASURY
MARGINAL INCOME 1988
PURCHASE OF PLANT 1990
TAXES
TAX RECEIPTS
TAXES
TAX CREDITS
GREAT PLAINS GASIFICATION ASSOCIATES
PARENTS OF GPGA
THIRD PARTY PURCHASE OF PLANT

Mr. Synar. Let me ask you something, you just got back from Korea, right?

Mr. Mares. Yes, sir.

Mr. Synar. You are trying to interest some of our allies in our nuclear technology, right?

Mr. Mares. The Department of Energy is a supplier of enriched uranium——

Mr. Synar. That was the purpose of the trip. You didn't happen to find an investor for a coal gasification project, did you?

Mr. Mares. No, I wasn't out marketing that technology on that trip.

Mr. Synar. Let me see if I can understand exactly what the administration's position is on this project.

I would like to insert into the record as exhibit A, a letter of May 21, 1985, from Secretary Herrington to SFC Chairman Noble.

[The letter follows:]

THE SECRETARY OF ENERGY
WASHINGTON, D.C.

May 21, 1985

Honorable Edward E. Noble
Chairman of the Board
U.S. Synthetic Fuels Corporation
2121 K Street, N.W.
Washington, D.C. 20586

Dear Mr. Noble:

In response to your letter of May 9, 1985, regarding the Great Plains Gasification Associates (GPGA) Project, I am pleased to provide you with the position of the Administration.

A price guarantee assistance agreement has been negotiated by your staff and the sponsors of GPGA. We are not opposed to a price support agreement. Indeed, we believe it may well be required in this case. However, there is no Administration interest in providing a large federal subsidy for a brief period of operation. Since the information gained from lengthy operation of the plant is the major national benefit from its operation, we believe every effort should be made in negotiating such an agreement to ensure long-term operation of the plant and maximum additions to the synthetic fuels data base.

The Department of Energy believes such an agreement is likely to have more tangible and intangible benefits for the U.S. taxpayers, the Nation, and the U.S. Government than if such agreement is not concluded with the sponsors and they terminate their participation in the Great Plains Project. The sponsors have indicated that they will terminate their participation in the Project if such agreement is not promptly concluded. There are some scenarios whereby an abandonment by the sponsors of their participation in the Great plains Project may provide a greater cash return to the U.S. Government, in its entirety, than proceeding with the price guarantee assistance agreement. However, the additional returns to the Government resulting from abandonment must be weighed against the tangible and intangible benefits of proceeding with the agreement, particularly when the uncertainties concerning the Government's ability to achieve such a greater return are taken into account.

In conclusion, we urge the Board of Directors of SFC to approve and execute an appropriate price guarantee assistance agreement with the sponsors of GPGA as soon as reasonably possible.

Yours truly,

John S. Herrington

Mr. SYNAR. This letter says that the administration supports issuing the project price supports; is that correct?

Mr. MARES. It says we are not opposed to a price support agreement; yes, sir.

Mr. SYNAR. That's right.

It says that the administration has no interest in providing a large Federal subsidy for "a brief period of operation." The administration is interested in "long-term operation of the plant."

How would you define large Federal subsidy?

Mr. MARES. I think that you are tying that to a brief period of operation, and the judgment of the administration is that we should be striving to develop an agreement which would increase the likelihood of extended operation of this project.

Mr. SYNAR. It is kind of like pornography, you can't define it but you know it when you see it, right?

Mr. MARES. However you want to characterize it, sir.

Mr. SYNAR. Is $820 million a large Federal subsidy?

Mr. MARES. $820 million, or a number higher or a number lower is a large amount of money.

Mr. SYNAR. What does the administration consider "a brief period of operation"? How long are we talking about?

Mr. MARES. There is no precise limit of time or specific duration of time.

Mr. SYNAR. Is 4 or 5 years a brief period of time?

Mr. MARES. Under some circumstances, four or five might be brief, yes, sir.

Mr. SYNAR. Is 4 or 5 years a long-term operation?

Mr. MARES. In some circumstances, it might be a long period of time.

Mr. SYNAR. Under these circumstances, how long does the administration consider a "long-term" operation?

Mr. MARES. That decision will be made in the course of the discussions in negotiations.

Mr. SYNAR. GAO testified that based upon DOE's most recent price projections, the $820 million assistance package would be paid out to the sponsors by 1990. Is that correct?

Mr. MARES. That is my recollection, yes, sir.

Mr. SYNAR. OK.

GAO also indicated that after 1990, the sponsors will be facing sustained negative cash-flows for a long period of time based upon DOE's projections. Isn't that correct?

Mr. MARES. Yes, sir, that is correct.

Mr. SYNAR. Now, based upon the Department's most recent projections, is it likely that the sponsors will abandon the project in 1990? Isn't it likely that that will occur?

Mr. MARES. We are dealing there with what one assumes about the projected price for natural gas, and there isn't anybody that will stake their reputation or their career on it.

Mr. SYNAR. That's your Department's projections, right?

Mr. MARES. Those were the midrange preliminary projection of the NEPP 5 analysis. If NEPP 5 is done in the same fashion as NEPP 4, there will be at least two other projections as part of the analysis and I don't know whether they will be called a high case, midcase, low case, or whether they would be scenarios A, B, and

C—but I think that any person that has been struggling in either the energy business or the energy projecting business recognizes that there is no single forecast or projection, that is likely to occur.

Mr. SYNAR. Mr. Panek, let me see if I can get you to answer the question.

Based upon the Department's most recent projections, is it likely that the sponsors will abandon the project in 1990?

Mr. PANEK. Is it likely? Based upon the numbers in our preliminary estimates, I would say that there may be a significant likelihood.

Mr. SYNAR. Thank you.

Mr. PANEK. There may be.

Mr. SYNAR. See, that wasn't painful.

Mr. MARES. The decision would be made by the people at the time, and none of us know what it's going to be like.

Mr. SYNAR. As we discussed earlier, the sponsors' projections are even more pessimistic than DOE's. They have already notified the Department that they would likely abandon the project once the price supports are used up.

Mr. MARES. Excuse me, sir, you said they have notified us that they would be likely to abandon. I am not sure I am aware of an explicit statement to that effect.

Mr. SYNAR. We have a letter that was written to DOE from the sponsors and it is on the second page.

Mr. MARES. Is this the same letter that was discussed earlier?

Mr. SYNAR. Yes.

Mr. MARES. Did that not say something to the effect that they didn't see that under all circumstances there would be sufficient money available to pay off the debt?

I didn't recollect in that letter or statement what you just said.

Mr. SYNAR. I don't have the letter in front of me but I think the letter said if they can't pay their debt, they have one of two options.

Mr. YOUNG. The March 1 letter.

Mr. MARES. Yes, I have it.

Mr. YOUNG. The sponsors indicated that they doubted under their price projections that they could repay the guaranteed indebtedness.

Mr. MARES. That is correct. That is what the letter says, but that's not what the chairman said. I was only arguing that the chairman's statement was not what was in the letter.

Mr. YOUNG. The question, then, would be: If the sponsors cannot pay their debt, they would have one of two options, either to abandon or to come back to the Government for more money. Is that correct?

Mr. MARES. They have at least those options. They would have to determine what is their projection of the revenue stream likely to be in the future, and whether that warranted them and/or they were allowed under the then existing agreement, be it with the SFC and/or ourselves, to have the ability to withdraw under the terms and conditions that currently exist.

Mr. SYNAR. If $820 million is not enough to keep this project running as long as the administration would like, how much more of the taxpayers' money does Great Plains need, do you know?

Mr. **Mares**. I think that what we are all striving to develop here is a relationship which will lead to the extended operation of this facility, because I think there is a clear belief on the part of everybody that there is some value from an extended operation of this facility.

I think there is also a recognition that it will require some significant, not an insignificant, but some significant amount of Federal support of one form or another in order to have that happen. The exact amount of that support and the exact period of time for which we are striving to get the facility operated have not been determined as yet. We are dealing with a large amount of money, whether it is $820 million, whether it is a larger number or a smaller number, it is a lot of money. I think there are a lot of people that are striving as well as they can to ensure that the Nation does, in fact, get a substantial value from this project, which I believe we will.

Mr. **Synar**. What we are talking about here is a $2 billion facility, that has received $1.5 billion of taxpayers' loans, more than $500 million in tax credits, a special Federal Energy Regulatory Commission ruling which allows the plant to sell its gas at twice the current market price, and now, perhaps, another $820 million in Federal price supports. And all of this to keep a project running for 5 years, at which time it will probably, by the sponsors' own comments, shut down.

My question to you, Mr. Mares, is what does that say about the viability of commercial synfuels development?

Mr. **Mares**. I won't agree with all of the characterizations in your statement, and rather than picking at each one of them, let me address it this way. The projections of energy prices 4 or 5 years ago were very substantial prices for oil and gas in this country. The thought was that the amount of money that might be required in supporting synfuels would in fact be relatively low. In fact, the Nation is much better off because the price of oil and gas today, as well as for a long time in the future is a lot less than what we expected.

However, there is still a belief that there is value to be obtained for the Nation in operating these types of projects. I think there is a lot of value to be obtained and that is what we, and SFC, will be striving to obtain for the Nation.

Mr. **Synar**. You didn't answer my question.

Mr. **Mares**. Well, sir, I didn't agree with each of the characterizations of your statement.

Mr. **Synar**. Just answer me this: Given all the financial problems this project has, and the billions of dollars we have dumped into it, what does it say about the viability of commercial synfuels development?

Mr. **Mares**. I think it is going to be a while before there will be a commercial synfuels industry in this country. Yet, I also believe that there is a view that we share that there is value to the information from having had a few of these facilities operating, and that is what we are striving to achieve in this case. I think that the record to date of what we have learned and the types of information that we are learning is really very good, and that the Nation will have been well served for this investment.

Mr. SYNAR. Mr. Clinger?

Mr. CLINGER. Thank you very much, Mr. Chairman.

I believe you were here and heard the Synthetic Fuels Corporation witnesses testify.

Mr. MARES. Yes, sir.

Mr. CLINGER. Their belief, based on their price projections, is that the cost to the Federal Government would be no greater if we were to proceed with the price supports at the $820 million level as compared with abandonment of the project at this moment. Would you agree with that characterization?

Mr. MARES. I think that is a fair characterization of the analysis, yes, sir.

Mr. CLINGER. How about from the sponsors' point of view? Where are they better off, if they are to abandon now or at the conclusion of the period of the price supports?

Mr. MARES. I think the sponsors are going to be testifying shortly, so I think they are the best persons to respond as to how they are going to be—the effect of the price support proposal is to reduce the cash-flow and net income impacts on the corporation, or change them—reducing the adverse net income effects, during the period of price support, with the goal of encouraging the partners to continue with the project.

I think it is clear in everybody's mind that these partners have done an outstanding job of operating the project in an operational sense, and there is a great deal to gain by continuing this project as a continuing operation than to have it shut down and have us try to find a different way to operate it.

Mr. CLINGER. Certainly there are advantages to the Federal Government in terms of the information, intelligence, technological——

Mr. MARES. I think that there are at least several sets of assumptions that one could make to show that it is not just an informational advantage but there would be a very substantial financial advantage to the United States if the project could be continued with the current sponsors rather than trying to come up with a different alternative.

Mr. CLINGER. So you are suggesting that if abandonment occurs now there would be costs incurred to the Federal Government over and above what it would cost us vis-a-vis the present sponsors in order to attempt to have the project continued?

Mr. MARES. There are some assumptions that one could make that would show that an abandonment now is not in the best—just from just a purely financial standpoint—is not financially in the best interests of the U.S. Government. Conversely, there are assumptions that one could make that would say that abandonment now would be in the financial best interest of the U.S. Government. Both of those do not in any way take into account the informational aspects of in effect continuing with the same operation or any of the intangibles of allowing this project to go forward in a reasonably smooth way.

Mr. SYNAR. Will the gentleman yield?

Mr. CLINGER. Yes, be happy to yield.

Mr. SYNAR. What is OMB's position on this?

Mr. **Mares**. I am here representing the administration as an administration witness. I have said the position of the administration is that we are not opposed to a price support agreement. We, however, do believe there is no administration interest in providing a large Federal subsidy for just a brief period of operation.

Mr. **Synar**. But we don't know what that means.

Mr. **Mares**. You rarely know what the final results of a negotiation are until you conclude them.

Mr. **Clinger**. You seem to be agreeing with Mr. Corcoran's position on this at this time, and that is that the present negotiated package, restructuring package, is deficient in some way, and that we need to rethink the process.

What kind of an impact do you think that kind of rethinking will have upon the sponsors? And how long would you suspect that it might take to renegotiate?

Mr. **Mares**. I think that it was not a happy evening for the sponsors when they learned that the transaction which they had been negotiating for an extensive period of time was not going to be concluded forthwith.

I do believe, as I said in my opening remarks, that there is a clear recognition that there is value to the Nation to have this project operate for an extended period of time. The administration supports the concept of a price support agreement. I believe, as you have heard from the Directors of SFC, that they, too, agree that there is value to the Nation to have this project continue with this particular group of sponsors for an extended period of time. And that they believe there would be some circumstances wherein they would be prepared to enter a price support agreement. And what they have basically asked the administration to do is to look at, with the Federal financing bank, the loan to the project, and determine whether there is a way to restructure that loan which would be coupled in some fashion with price supports to put a negotiated deal together that would meet the Federal Government's interest, the Nation's interest, as well as the sponsors' interest. Because there has to be an accommodation, as was said, I think, very articulately by Mr. Groelinger, you have got many parties whose interests have got to be weighed and evaluated and taken into account, and try to make this thing go forward—I would say I am personally optimistic and convinced it is doable.

Mr. **Clinger**. The sponsors have indicated that they are coming up to a critical date—June 15. And that unless they have some assurance that there would be a renegotiated deal, they would have to consider implementing the process for abandonment.

Do you think that what you are suggesting can be accomplished by June 15? Or do you think it is serious?

Mr. **Mares**. Let me answer it this way. I am an optimist by nature and I am convinced that we, collectively, will figure a way to satisfy all the interests in a way that this project will go forward reasonably smoothly.

I am not going to give a specific date. But I am convinced that there is a clear interest and goodwill on all the parties' parts, including the Congress. I think that clearly Congress wants this project to be concluded in a way that it gets value for the Nation.

So I think in a way that this hearing has been very helpful in that regard, to crystalize the thinking of all parties on this project.

I can't guarantee something, June 15, but I think that there will be a lot of us working very hard over the next few days to come up with something.

Mr. **Clinger**. We, here, always try to be helpful.

Mr. **Mares**. I understand that.

Mr. **Clinger**. Thank you, Mr. Chairman.

Mr. **Synar**. Mr. Armey.

Mr. DeLay.

Mr. **DeLay**. No, thank you, Mr. Chairman.

Mr. **Synar**. Mr. Armey, do you have some questions?

Mr. **Armey**. Yes.

Mr. **Synar**. All right.

Mr. **Armey**. I am looking at page 21 on your prepared statement, the bottom paragraph. Apparently it is possible to mothball this facility. You indicate here the cost would be about $1½ million a month.

Mr. **Mares**. That's really not a mothballing. On the top of the next page we talk about mothballing. This is, in effect, just not operating it for a period of up to about 3 months. There is a difference between, just in effect, stopping and not operating for a short period of time, or stopping and not operating for an extended period of time.

Mr. **Armey**. OK.

Mr. **Mares**. You have to do quite different things. And the cost of an extended shutdown—on the next page is a guesstimate of the order of $100 million.

Mr. **Armey**. $100 million.

Mr. **Mares**. It isn't cheap.

Mr. **Armey**. Now, $100 million of maintenance cost—in that case, of $500,000 a month.

Mr. **Mares**. Yes, after you have, in effect, done all the things. The sorts of things you have to do for an extended shutdown would be to clean out the pipes, put in inert gas. I mean, it is not a simple matter.

Mr. **Armey**. I understand. And especially in that climate, I am sure it is even more so.

Mr. **Mares**. You don't want to have any moisture in those pipes.

Mr. **Armey**. If you are operating, you hire 800 personnel?

Mr. **Mares**. I believe the current staff is over 800 personnel, sir.

Mr. **Armey**. I am really intrigued by these figures. I am back on page 21. With a shutdown, you have 50 operating personnel, 30 maintenance personnel, and 20 security personnel. And it is going to cost $1½ million.

Mr. **Mares**. I hope that we are not in such an effort to do that.

Mr. **Armey**. Obviously, we have to make a decision given where we are, and in the interest of all the parties concerned. When you consider 800 or more people being employed in the State of North Dakota, I can well imagine that the interest of the State is in having a continued operation of the gasification plant, which was represented by Mr. Dorgan earlier.

If we did not extend the $820 million price guarantee, we would save that. Assuming, then, that the partners would default and vacate the property, we would receive then back tax credit and a capital structure that has embodied in it a tremendous amount of technological knowledge and learning, and so forth, that presumably has some value for future emergency and is capable of being mothballed for that time, right?

Mr. MARES. The facility has not operated long enough that this body of knowledge that you are describing is that useful for the long term. We do have the knowledge of having built the plant. We do have the knowledge of the environmental permits that were required to get the plant to the state that it is today. But we have not solved—although we are convinced we can—we have not solved all the operating problems, or the environmental problems. And that's one of the reasons that the Nation will be very well served by operating this plant.

I might point out one thing, that there were some comments earlier about this being a technology that has been used before. It is clear the gasifiers have been used for different types of coal, in different continents, but none have been used for lignite, which is really an enormous resource for this country.

Mr. ARMEY. I appreciate what you are saying, but I want to go on here because I am still trying to figure out what is the best option for us given where we are and where we are going to have to go.

Mr. MARES. Right.

Mr. ARMEY. I want to make it very clear, in my estimation, that if there is a culprit in this matter, the blame rests largely with the Government, not private business. But that is just a matter of my point of view.

We would save $820 million. We would get a plant that has a market value of someplace in the neighborhood of $300 million, if you were to sell it.

Mr. MARES. If you could sell it.

Mr. ARMEY. Then $350 million or so, as it were, in back taxes. I have to assume that any time you spend this much amount of money to building a capital structure that it is of some value to somebody in some way, and should be worth having if it is capable of being mothballed. That is starting to look to me like a fairly decent option.

Mr. MARES. Do you want me to comment?

Mr. ARMEY. Yes, would you?

Mr. MARES. I didn't follow your particular assumptions in terms well enough to evaluate how they compared in the financial analyses to the ones that we have done as well as the ones that SFC has done.

I would agree that the analyses that have been done to date would indicate that on a discounted basis there are some circumstances whereby having an abandonment of the plant to day makes financially more sense for the Nation than having the project go forward with the price supports. That's simply looking at it only on a cash-flow standpoint. However, there are some very significant assumptions that are made in all of these analyses. One of the most critical is, whether you can find a buyer and at what price; what that buyer would pay for the facility, and obviously, one of the very critical assumptions is what range in the assumptions you want to make about future oil and gas prices.

Mr. **Armey**. I understand all of this is figured tentative. One of the things that I would like us not to lose sight of is that it took Mother Nature billions of years to give us that coal reserve and if, indeed, we want that capability for a national emergency, it does us very little good to use it up when we don't have a national emergency. Because every time we mine a ton of coal, we are taking a ton away that won't be replaced, and this is why these national emergency arguments have always bothered me in that regard.

At one time we were pumping oil out of the ground at 100 miles an hour so that we would have it for a national emergency. It always escaped my notice how we would have it if we were burning it up.

Mr. **Mares**. I think the response to that is, yes, if you take a ton of coal out of the ground it is not replaced in a timely fashion. But what we will derive from that is a very significant intangible benefit which is the knowledge and the experience which is translatable and transferrable to other projects and to other entities over time—and that is the value of the project.

Mr. **Armey**. I have one parting comment. The knowledge would do us scarce good if we didn't have the coal to burn that knowledge on, and that is what I am concerned about.

Mr. **Mares**. All right. Then that is a judgment call as to whether you are using up so much coal that it cuts into the base.

Mr. **Synar**. Mr. Mares, do you remember the first time we met?

Mr. **Mares**. I remember it, sir.

Mr. **Synar**. What was it about?

Mr. **Mares**. It was about the ultimate transfer of the Bartlesville Energy Technology Center to being operated by a private sector organization.

Mr. **Synar**. What did you tell me at the time, about why the Government couldn't continue the Bartlesville Research Center, we had to turn it over to the private sector? Didn't you tell me we couldn't afford to continue it and it was a business that the Government shouldn't be in, it should be in the hands of the private sector? Weren't those the reasons you gave me for——

Mr. **Mares**. Certainly, the latter one is the reason. I think the former one was based upon a judgment of how much——

Mr. **Synar**. About $25 million, wasn't it?

Mr. **Mares**. No, sir, the annual operating budget at Bartlesville was at that time, if I remember correctly, about 10 or 11.

Mr. **Synar**. Ten or eleven? Even less than I thought.

The point was that you killed the Bartlesville Research Center because——

Mr. **Mares**. No, sir, that facility is operating very well. It is being operated by the Illinois Institute of Technology.

Mr. **Synar**. But we took it out from under the Government. The Government quit paying for it because you said we couldn't afford it.

Mr. **Mares**. The Government is paying less today for it and it is thriving well.

Mr. **Synar**. OK, I don't want to get into semantics.

The point is, when did you change your attitude about what Government should be in and what Government shouldn't be in?

Mr. **Mares**. The Government is still supporting the Bartlesville operation just as the Government is supporting, through the Federal loan guarantee, the Great Plains project.

Mr. **Synar**. That's correct, they are doing that.

Let me ask you this. You heard GAO testify earlier today that they thought that one of the options that should be considered is the option to draw down the $480 million remaining on the original loan. Since you have announced, or it has been announced, in just the last 48 hours that there will be renegotiations on this whole thing, can I get your assurances for the subcommittee that DOE will seriously look at that as an option that would be considered?

Mr. **Mares**. Sir, we have looked at anything you have asked us to look at.

Mr. **Synar**. The other reason I ask for that is, even though it is not the committee's responsibility nor will we ever try to make a decision on the conflict of interest issue, the appearance of the conflicts of interest may necessitate this as the only option available for us, since the Board would not be able to make a decision if the ethics officer——

Mr. **Mares**. Which being the only option?

Mr. **Synar**. The $480 million drawdown.

Mr. **Mares**. What is your basis for suggesting that that is the only option?

Mr. **Synar**. Because the rest of the options would require a vote by the Board of Directors, of which two members may have a potential conflict of interest.

Mr. **Mares**. What is it about that option that did not involve SFC?

Mr. **Synar**. It doesn't require any decision by the Board.

Mr. **Mares**. From reading the testimony, I didn't follow that point. I will have to go back and try to understand what they were saying.

Mr. **Synar**. I think the real point is, Jan, that we want that option to be considered.

Mr. **Mares**. We will certainly evaluate it, sir.

Mr. **Synar**. Again, I apologize for the lateness of the hour in getting you up here. I hope that this won't happen again.

Mr. **Mares**. Oh, great things brings out the best of us, sir. It is fun to be here.

Mr. **Synar**. Thank you very, very much.

Our final witness today will be Mr. C.W. Rackley, chairman of the Great Plains Gasification Associates.

Mr. Rackley, do you have any objection to being sworn in?

Mr. **Rackley**. No, sir.

[Witness sworn.]

Mr. **Synar**. Let me extend to you the same apology that I just gave to DOE. It was not our intention to go this long but, regrettably, the questions took a little bit longer than expected. We would appreciate it if you could summarize in 5 minutes and then we will try to get into questions as quickly as possible and get you out of here.

Welcome.

STATEMENT OF C.W. RACKLEY, CHAIRMAN, GREAT PLAINS GASIFICATION ASSOCIATES

Mr. **Rackley**. Mr. Chairman, and members of the committee, my name is C.W. Rackley. I am chairman of the Great Plains Gasification Associates, a North Dakota partnership that has constructed the Nation's first commercial size synthetic fuels project in Mercer County, ND, on time and within budget.

This facility, that is capable of producing 125 million cubic feet a day of natural gas quality, is really a national treasure.

Mr. Chairman, my prepared remarks were based upon the expectation that the agreement that we have negotiated with SFC over the last 17 months would be approved. Based upon the discussions and the alternative proposals discussed in earlier testimony here today by others, that now appears very much in doubt.

Under the circumstances, it does not appear appropriate for me to deliver my prepared remarks. The only point that I believe I should make today is that the Great Plains sponsors view these developments with the gravest of concern. The project is at a critical stage and we must have a resolution soon. Although we must, of course, consider any other alternative the administration or the SFC may propose, time is running out. To say the least, for new concepts to be introduced after 17 months of negotiations, is astounding to us businessmen.

I would be glad to accept any questions.

Mr. **Synar**. Just for a point of reference, do you or do you not want your prepared statement put into the record?

Mr. **Rackley**. It may be put in.

Mr. **Synar**. With unanimous consent it will be.

[The prepared statement of Mr. Rackley follows:]

COMMITTEE ON GOVERNMENT OPERATIONS

HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON ENVIRONMENT, ENERGY AND NATURAL RESOURCES

Hearings on Great Plains Gasification Associates
Synthetic Natural Gas Project

May 22, 1985

Testimony of C. W. Rackley

Chairman

Great Plains Gasification Associates

C. W. RACKLEY, CHAIRMAN
GREAT PLAINS GASIFICATION ASSOCIATES

BEFORE THE HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON ENVIRONMENT, ENERGY, AND NATURAL RESOURCES
COMMITTEE ON GOVERNMENT OPERATIONS
HEARINGS ON GPGA PROJECT
MAY 22, 1985

Mr. Chairman and members of the Committee, my name is C. W. Rackley. I am the Chairman of Great Plains Gasification Associates, a North Dakota partnership that has constructed the nation's first commercial size synthetic fuels project in Mercer County, North Dakota. The partners of Great Plains and their ownership interest in the partnership are affiliates of Tenneco Inc. (30%); American Natural Resources Company (25%); Transco Energy Company (20%); MidCon Corporation (15%); and Pacific Lighting Corporation (10%). Construction of the facilities has been completed on schedule and the plant is in startup and testing. Numerous de-bottlenecking, operability and environmental modifications are underway.

Mr. Chairman, I want to thank you for giving Great Plains the opportunity again to report to you and your Subcommittee on the progress we have made in giving this nation a working model for the production of synthetic fuels. Great Plains represents a unique partnership between Government and the private sector. The recognition by Congress that energy independence is an inescapable long-term priority of our nation gave birth to this project. The private sector would not have undertaken this project alone, but working together with the Government we have made significant progress toward our shared goal.

As you may recall, Great Plains appeared before your Subcommittee in October, 1983, and made a logical case for the United States Synthetic Fuels Corporation to provide price support assistance to the project. During the intervening months, the Corporation has negotiated an $820 million price support assistance and restructuring package which will enable this very important project to go forward, subject to approval by the respective Boards.

Our negotiations with the Corporation were based upon the premise that we would assume the design, procurement, construction, start-up and operational risks associated with the project and that the Corporation would share in a major portion of the market risk. Because of the downturn in energy price projections, the project cannot carry its debt load without price support assistance.

Exclusive of the debt, the project is self-sustaining and should continue to operate. Thus, the focus should be on how to handle the debt.

Without the restructuring agreement, the current debt service amounts to about $190 million per year until principal repayment begins in 1988. At that time the debt service increases to about $280 million per year, or the equivalent cost of about $6.50/MMBTU of gas produced or $38/bbl of oil. When the DOE Loan Guarantee Agreement was consummated in January, 1982, Great Plains projected prices to be about $67/bbl in 1988. These projections were in line with those of DOE at the time. Energy prices have dropped as has our expectation of inflation. Oil prices are currently at about $28/bbl. Our recent experience has left us with a very low confidence level in any price projection. Currently, we are projecting flat to declining prices for the next few years. Our current estimates for 1988 range between $24 and $31/bbl, with our most likely estimate at about $29/bbl. Forecasters say the period for low pricing should be near its end by then, but the benchmark then for future increases will be much lower than under our earlier projections. The project can cover its operating costs and prove up the goals of the Energy Security Act, but because of the dramatic decline in energy prices, it cannot pay the interest and principal on the DOE guaranteed debt without SFC price assistance.

Quite frankly, today Great Plains has only two options -- accepting this SFC price guarantee and restructuring package or abandoning the project. I will address each approach, but first let me explain why the Great Plains' Sponsors cannot operate without Federal price supports. Without assistance, the cumulative book income losses are projected to total over $500 million by the end of 1989 and to continue to climb to near $1 billion by the end of 1994. Annual losses could reduce the net income of some of the Sponsors by as much as 20%. A prudent businessman cannot permit his company to sustain such losses. The Sponsors have a fundamental responsibility of maximizing the value of their stockholders' investment. Moreover, the Sponsors are rated in the financial community, among other things, by the ratio of earnings to fixed charges and earnings growth. Absorbing these large book losses would cause a general discounting of their borrowing power. If investor perception of a project is generally negative, investors tend to look more favorably on a one-time write-off than they do upon a prolonged negative impact on earnings.

While I have emphasized book earnings, the Sponsors' exposure to cash losses are projected to increase by $300 million over the first five years and climb to nearly $1.2 billion by the end of 1994, assuming we would continue to operate and service the debt. This is an equally unacceptable result.

Therefore, Great Plains has only two options:

1) Our preferred option is to obtain the $820 million SFC price guarantee and restructuring package which should permit the operation of the plant through 1989 under stringent guidelines and beyond 1989 if economic and national considerations permit.

2) Termination of the project is the obvious alternative to operation without SFC price supports. Great Plains can abandon the project now since at least two events have occurred which permit termination under the Department of Energy Loan Guarantee Agreement. In this instance, we turn the keys over to DOE and walk away, triggering a default on the Federal Financing Bank (FFB) loan. DOE would be required immediately to repay the $1.46 billion of guaranteed indebtedness.

Let me compare how the Sponsors come out by accepting the SFC price guarantee and restructuring package versus abandonment. On the financial side, we would be able to avoid the immediate book write-off of about $530 million of our equity that would be required by abandonment. We would also avoid repayment of approximately $300 million of abandonment taxes. Based upon current projections, Table #1 illustrates the total parent cash exposure from abandoning the project, including the recapture of certain tax credits, for the 1985 through 1989 timeframe with the SFC package. It illustrates that a short-term deal is not acceptable because the Sponsors are considerably worse off during the first four years than if abandonment occurs now.

TABLE #1
GREAT PLAINS GASIFICATION ASSOCIATES
ABANDONMENT PARENT CASH EXPOSURE, YEAR END
($ - MILLIONS)

1985	1986	1987	1988	1989
330	415	480	426	343

The SFC price support package will give us both the time and the incentive to determine if the project's economics can be improved by exceeding the design operating capacity of the plant, sale of by-products, and reducing operating costs. Further, anything less than five years is too short a period to expect an oil price recovery to occur.

BEST COPY AVAILABLE

If, at the end of the price support period, future gas price projections or other economic factors have not improved over our current projections, we still will have to terminate the project. If this occurs, we sustain about the same cash exposure upon termination.

Despite a requirement for $190 million of new equity, the SFC price guarantee package contains several features which can make it acceptable to the Sponsors. If production projections are met, the package provides for return of most of the new equity near the end of the price support period and provides that about $670 million of the DOE guaranteed debt will be repaid in an accelerated manner in order to ease the interest burden beyond 1989. As a consequence, the chances for continuing the project are improved.

Over the first five years of the price support period, our net income ranges from minus $28 million this year to a plus $13 million as shown in Table #2.

TABLE #2
GREAT PLAINS GASIFICATION ASSOCIATES
PARTNER NET INCOME
($ - MILLIONS)

1985	1986	1987	1988	1989
-28	-26	13	13	1

These returns, which add up to a -$27 million, can hardly be considered a "windfall" when we will have invested substantial new equity during the first three years.

The Sponsors are optimistic about this package. We believe it provides incentives for operating improvements along with a business opportunity to operate the project for a long period of time if energy prices or other economic factors improve from the current projections. The SFC package should provide support during a period within which gas prices and some important by-product sales could increase enough for the project to be self-sustaining and eventually pay off the DOE guaranteed debt.

Now, let me tell you about the benefits to the nation with the SFC price support package versus abandonment. Assuming successful operation of the plant during the next five years, the nation achieves many of the original objectives in the Energy Security Act as they relate to coal-based synthetic fuels. The technical viability of some of the processes to convert North Dakota coal has already been demonstrated. However, all of the environmental problems have not yet been solved. As you may recall, this was one of the major objectives of the Energy Security Act. The principal future benefits from continued operations will be demonstrating that coal can be converted to pipeline quality gas in an environmentally safe manner and also proving the operating cost, capacity and long-term operability factors of the plant. When future economic or national security circumstances dictate, coal gasification technology could easily be replicated to provide a basis for a domestic synfuels alternative, so long as we continue to cultivate the technology. The plant could also serve the national interest as a laboratory for slip-stream testing of other processes and coals. From the balance of payments standpoint, this project has the potential to replace $230 million of equivalent imported oil each year at today's low prices. Instead, approximately this amount of money is going into North Dakota and the surrounding economy.

The obvious question is -- what are the Sponsors going to do? We are in the final stages of commissioning the plant and we fully expect to place it officially in service about June 15, 1985. I have been advised by my partners that they cannot tolerate this year's book losses if a price support package is not executed by the in-service date. They have told me they will request a meeting to initiate the Loan Guarantee abandonment procedures.

Mr. Chairman, I can tell you the Sponsors don't want to abandon this project at any time, especially when the Government is pursuing deficit reductions. We are willing to share the risk with the Government by investing $190 million of additional capital to operate this plant for about five years while awaiting a possible turn-around in energy prices. The issue, which no one can predict with certainty, is how much and how rapidly will oil prices change. The accelerated repayment of DOE debt under the proposed support agreement is of great importance to the Sponsors, since it improves our chances of surviving with a commercially viable project. If the plant is able to operate profitably in the future, the SFC's package requires that 90% of the project's cash flow will be dedicated to finishing repayment of the guaranteed debt. After repayment of debt, the Government will then profit share to the extent of 75% of available cash flow. In other words, the taxpayer stands to benefit financially as much or more than the Sponsors from continued successful operation of the project -- first in minimizing exposure to debt default and, second, in getting the lion's share of profits if and when oil prices or other economic factors increase enough to make the operation profitable. We believe that it is in the country's best interest to share today's unacceptable market risk with us. In doing so, we complete the Congressionally mandated first step toward greater energy security and the Federal Government shares the potential financial returns which could eventually come with higher energy prices.

The SFC price guarantee package is no "windfall" to the Sponsors. It does represent the better of two difficult options. The cost to the nation to finish the job is small relative to the investment to date toward an unfinished goal.

Mr. Chairman, Congress established the U.S. Synthetic Fuels Corporation to fund projects just like this one. Considering our domestic energy and national security goals as well as the Sponsors' strong commitment, it would be wasteful and imprudent for the Government to abandon the project at this stage.

Mr. SYNAR. Mr. Clinger, why don't you go first for 5 minutes.

Mr. CLINGER. Thank you very much, Mr. Chairman.

I gather that you are somewhat dismayed by the prospects of opening up the agreement which you have been negotiating for the last 17 months.

Mr. RACKLEY. Yes, sir.

Mr. CLINGER. How would you view opening up the present agreement with DOE to restructure the debt repayment to delay repayment until later years when, as has been suggested by some, there would be greater profits to do so?

Mr. RACKLEY. A simple restructuring of that debt would not be considered attractive by the sponsors. We have looked at it. It would cause excessive book losses to the sponsors during the upcoming years. To consider that at all, there would have to be some very creative approaches to dealing with it. We will remain open to considering any creative approaches. But as a simple restructuring of the debt, it will not be viable.

Mr. CLINGER. You have heard the previous witnesses this morning. Obviously, one of the concerns on the part of DOE and on the part of Mr. Corcoran in particular, is that we have some greater assurance of the long-term operation of this facility, some sort of guarantee at least to improve the prospects that we would see the facility operated for its contemplated lifetime.

What would be required for you, that is, for the sponsors, to give assurances to the SFC to continue operating the plant through the 1990's? Or are there any assurances that could be given to you that would permit you to make that kind of commitment?

Mr. RACKLEY. Are you saying an unconditional commitment to operate it, for example?

Mr. CLINGER. I suspect that's not possible to answer. But what would be required to permit you to make some kind of conditional commitment that you would operate it through the 1990's?

Mr. **Rackley**. It would take enough price supports or the equivalent to get our prospects of operating without cash losses and book losses during the period of time under consideration.

Mr. **Clinger**. The plant is presently operating. What is the significance of the June 15 date? What occurs on June 15?

Mr. **Rackley**. It is estimated that the project would go into service at that time for dealing with the DOE debt. That's our estimated date for going in service and we would no longer be able to capitalize the interest on the debt. The project sponsors would have to recognize that interest cost as an expense against their books.

Mr. **Clinger**. We had certain objectives in mind when this project was commenced some years ago. You have been operating the plant. Everybody agrees that you have been operating it in an excellent fashion. But haven't we achieved the goals that we set out to achieve when this project was instituted?

Mr. **Rackley**. We have only partially achieved certain goals. We have proved that we can gasify North Dakota lignite into pipeline quality gas. This is a very significant achievement. It cost a lot of money to do it. It is worth a lot to the Nation to know that they can do that.

Mr. **Clinger**. What more do we have to prove?

Mr. **Rackley**. We have not proven that we can do this completely environmentally safe. We still need more time to do this but we believe we can get it accomplished within, say, the next 12 to 18 months. But that work is unfinished and it is a small price to pay for us to learn that we can do this environmentally safe. After all, this was one of the key terms of the Energy Security Act.

Mr. **Clinger**. Mr. Rackley, you have heard testimony here earlier and you have heard the chairman's line of questioning to some of the witnesses. What is your reaction to a $480 million level of assistance that the chairman has mentioned? How would this impact upon your decision whether to abandon or not abandon?

Mr. **Rackley**. This was considered during the negotiations with the SFC and it was flatly rejected.

Mr. **Clinger**. By the sponsors?

Mr. **Rackley**. By the sponsors.

Mr. **Clinger**. In your view, has anything changed that would lead you to reconsider that rejection?

Mr. **Rackley**. As a simple price guarantee payment, we have no reason to believe that that would be considered. I might give you some feel for the problem with it. It does not carry the project far enough. It doesn't bring the debt down enough and carry the project far enough for us to believe that prices will rise to where that plant can be self-sustaining.

The sponsors need to believe that the deal we make is sufficiently sound that at the end of that time that there is a chance that we can go forward and carry this plant on for a long period of time.

Mr. **Clinger**. You state in your testimony that you have two options. One, either go forward with the deal which you have negotiated, the $820 million price support level; or abandon the project.

You are now advised that SFC and DOE want to reconsider that negotiated contract. Do you still contend you only have those two options or are you willing to consider some further restructuring at this time?

Mr. Rackley. We are a creative people. We will be happy to consider anything that is a creative approach to solving the problem that would make it appear that the project has a chance of being viable, but we are very pessimistic about being able to negotiate something in the short period of time that remains.

Mr. Clinger. The June 15 date is still critical?

Mr. Rackley. It is still a very critical date to us.

Mr. Clinger. Thank you, Mr. Chairman.

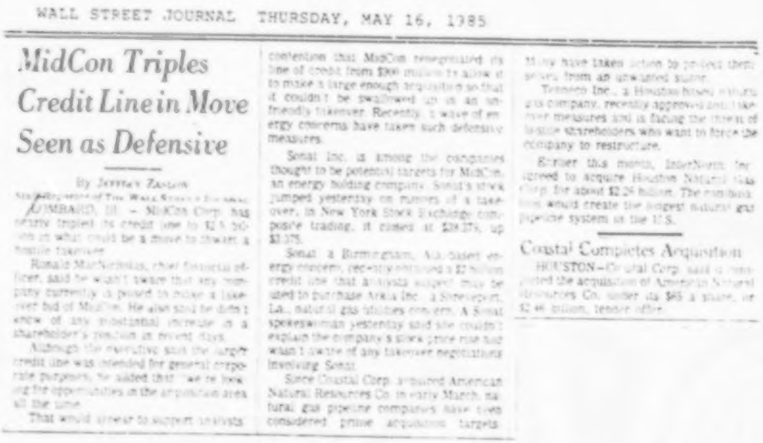
Mr. Synar. The Chair will take 5 minutes.

Mr. Rackley, I think it would be appropriate for me to express what my true concern is here. In 1982, we, the Government, and you, the partners, went into an agreement, an equal agreement about what we were trying to do. Since that date, we, representing the taxpayers, have kept our commitment with $1.5 billion in loans, and we're now considering $820 million more.

I think what I am interested in trying to review here is what you all are committed to. I think that is important.

I would like to insert into the record, if I could, exhibit No. 10, which is an article from the Wall Street Journal of May 16.

[The article follows:]



WALL STREET JOURNAL THURSDAY, MAY 16, 1985

MidCon Triples Credit Line in Move Seen as Defensive

By Jeffrey Zaslow

Coastal Completes Acquisition

Mr. Synar. This article reports on efforts underway by MidCon to thwart a hostile takeover. It points out that since Coastal took over American Natural Resources, natural gas pipeline companies have been considered prime acquisition targets. It says, "Many of these companies have taken action to protect themselves from the unwanted suitor." It further notes that Tenneco is "facing the threat of hostile shareholders who want to force the company to restructure."

Mr. Rackley, when we talk about protecting stock values, are we really talking about protecting managers of companies that want to keep their jobs?

Mr. Rackley. Absolutely not. We are concerned about the equity of the stockholders, and that is the only issue.

Mr. **Synar**. Do you consider your application to the Synthetic Fuels Corporation in part an effort to protect your company from unwanted suitors?

Mr. **Rackley**. No.

Mr. **Synar**. Then the book losses aren't that threatening to you?

Mr. **Rackley**. What is your question?

Mr. **Synar**. Then the book losses are not that threatening, if you are not worried about a hostile takeover?

Mr. **Rackley**. I would like to correct that. The book losses are important to us and hostile takeover is only an incidental thing that very few of us concern ourselves with. We are concerned about protecting our current shareholders' equity, and improving that with time. That is our only concern.

Mr. **Synar**. OK, let's go on.

We made a bad decision, I think, in 1982, and that decision was made by two parties: The Department of Energy and the companies that you represent.

We have 1.5 billion dollars of taxpayers' money on the line here. And you are here today telling us that we should invest even more of our taxpayers' money so that you don't catch what I think is a tremendous amount of pressure from your stockholders. Isn't that really what the bottom line is here today?

Mr. **Rackley**. That we don't do what? Give me your question again.

Mr. **Synar**. The question is: Isn't the bottom line of this whole discussion today that we are trying to protect you all against catching hell from your stockholders?

Mr. **Rackley**. I don't see it that way at all. We have participated with the Government in building the first large coal gasification plant that was aimed at fulfilling the needs of the Energy Security Act.

We both went into this believing that prices would be better, that this would be a success. We have a genuine interest in not walking away from that guaranteed debt. We are very much concerned about that. However, the deal was that we had the right to walk if certain circumstances have been triggered, and this deal does not look attractive unless we can get some improved financing on it.

Mr. **Synar**. Mr. Rackley, you noted in your prepared statement that the sponsors are cognizant of the Nation's deficit problems. You said that the sponsors were, therefore, willing to "share the risks with the Government by investing $190 million of additional capital."

Under the SFC's April 1984 proposal for $790 million, the sponsors would have kicked in an additional $100 million to the project. Is that correct?

Mr. **Rackley**. That's correct.

Mr. **Synar**. So the current $190 million commitment represents an increase of $90 million in equity the sponsors are now willing to contribute to the project; is that correct?

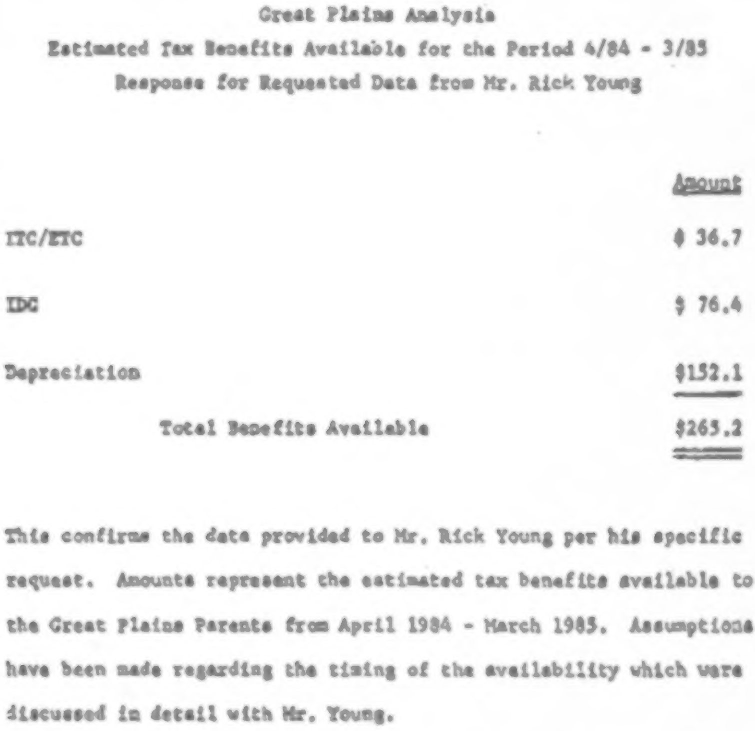
Mr. **Rackley**. That's correct.

Mr. **Synar**. Now, I am interested in this increased commitment because, in the past, Mr. Noble had testified that under the new

SFC proposal, the sponsors are increasing their equity commitment to almost 100 percent.

I would like to introduce into the record at this time exhibit 11, which is a response from the Department of Energy to a request from this subcommittee.

[The document follows:]



Great Plains Analysis

Estimated Tax Benefits Available for the Period 4/84 - 3/85

Response for Requested Data from Mr. Rick Young

	Amount
ITC/ETC	$ 36.7
IDC	$ 76.4
Depreciation	$152.1
Total Benefits Available	$265.2

This confirms the data provided to Mr. Rick Young per his specific request. Amounts represent the estimated tax benefits available to the Great Plains Parents from April 1984 - March 1985. Assumptions have been made regarding the timing of the availability which were discussed in detail with Mr. Young.

Mr. SYNAR. This analysis reviews the tax benefits which have accrued to the project sponsors between the time of the original SFC proposal and the current proposal. It indicates that over the last year, the sponsors have had tax benefits of $265 million available to them.

Is that information accurate, to your knowledge, Mr. Rackley?

Mr. RACKLEY. I would have to get that supported by our financial people. I would be glad to do that and confirm it to you.

Mr. SYNAR. Are they here?

Mr. RACKLEY. Yes, I have some I can check with.

Mr. SYNAR. Do you want to ask them?

[Pause.]

Mr. SYNAR. The question is whether over that period of time the sponsors have had over $265 million available in tax credits.

[Pause.]

Mr. Synar. Is somebody going to answer that?

Mr. Rackley. Yes. Just a minute.

Mr. Synar. OK.

Mr. Rackley. To proceed with your question——

Mr. Synar. Just supply that for the record.

[The information was not furnished for the record.]

Mr. Synar. Under the new SFC proposal, the sponsors have the right to recover their $190 million investment after March 1988; is that correct?

Mr. Rackley. Yes.

Mr. Synar. All right.

Under your price projections, how long will it take for the sponsors to recover this $190 million equity investment?

Mr. Rackley. Under the SFC proposed deal? We will recover that——

Mr. Synar. By 1990?

Mr. Rackley. Yes, by 1990.

Mr. Synar. So you expect to have that $190 million investment recovered by 1990, and at that time you estimate that $670 million in DOE debt will have been repaid; is that correct?

Mr. Rackley. Yes, sir.

Mr. Synar. So by 1990, the sponsors will have recovered their additional investment entirely, and the Government will have invested an additional $820 million to get back $670 million. And by 1990, the taxpayer will be out another $150 million on their investment while the sponsors break even on theirs. Now, is this what you are referring to in your statement when you said, "Great Plains represents a unique partnership between government and the private sector"?

Mr. Rackley. We have at risk at the present time something over $300 million of tax credits that would have to be recovered should we abandon. So we have a substantial equity at risk in this project. We feel that our approach to this has been fair and equitable. There is no assurance that we will get this money back by any means, and we feel that the risk on both sides are about equal.

Mr. Synar. If you will excuse me for a second. I am going to run next door and vote, and let Mr. Clinger chair for just a second.

Mr. Clinger [presiding]. Have you finished with that answer, sir?

[No response.]

Mr. Clinger. Mr. Armey.

Mr. Armey. Thank you.

Mr. Rackley, I have got a couple of questions. You are now producing and distributing gas? Are you distributing gas now?

Mr. Rackley. Yes.

Mr. Armey. To what geographic locations do you distribute the gas?

Mr. Rackley. The gas is sold to the sponsors in general—Tenneco takes 30 percent, Transco takes 20 percent, and the other sponsors take the remainder into their respective systems.

Mr. Armey. So, the gas is distributed widely?

Mr. Rackley. Scattered throughout the country.

Mr. Armey. Throughout the country, OK.

So, wherever that gas is going it does represent geographic locations that would have alternative sources?

Mr. **Rackley**. In the short term?

Mr. **Armey**. Yes.

Mr. **Rackley**. In the short term, there are alternative sources. We should look at the long term. This project was based on the long term.

Mr. **Armey**. I understand. You might find a situation where you should have a place like Bismarck, ND, enjoying the advantages of natural gas because of the proximity of this plant, yet normal market forces would dictate the use of an alternative, more efficient fuel source. This project, coupled with Federal assistance, alters the true market value of energy resources. It also alters the tradeoffs associated with using alternative forms of diminishing resources, promoting the use of energy sources which might be more valuable left in the ground. While we have large amounts of coal reserves, we don't yet—at least from what I have seen—have the technology to produce gas from coal at market rates.

Were you around at the time your company and the others first entered this agreement?

Mr. **Rackley**. I did not participate in the Great Plains organization at that time.

Mr. **Armey**. I am still very curious where this whole idea originated. Did it originate from your side or from the side of the Federal agencies?

Mr. **Rackley**. This project was put together in response to the public demand for an alternative to our energy needs. The sponsors were thinking in terms of doing this and had done some work very early. If I recall, years like 1972-73, when the first gas crisis became significant. Perhaps you fellows remember when the gas crisis became significant.

Mr. **Armey**. I remember it well.

Mr. **Rackley**. This project came to fruition as a result of the general crisis that came in 1979-80, and there was a general demand by the Government to also get this done.

Mr. **Armey**. I understand that. If I could sort of put it in a common parlance—in effect, what you were doing was sitting around tending your affairs and all of a sudden you picked up a trade journal or a Government document and you saw the Government was looking for people who would enter into a partnership to respond to this crisis, and they will assist energy innovations that perhaps would not be supported by free market circumstances. And here's a condition where we might make a further contribution not only to the Nation's energy needs but to our own desire to stay in business to grow and prosper, right?

Mr. **Rackley**. I would like to correct one aspect of that. The concept at that time was that the Government was willing to offer loan guarantees to assist and the prospects for prices were such that support subsidies would not be needed. Therefore, we went forward building this on the prospect of only getting loan guarantees. We did not expect it to be subsidized except during the first 5 years that we got assistance out of FERC.

Mr. **Armey**. So the contractual relationship, the development, the production of the plant, and so forth, all of this was a very happy relationship until you became ready to go on line and the prices did not materialize at a level that was high enough to sustain your operating needs?

Mr. **Rackley**. That's correct.

Mr. **Armey**. At that point, you came back and said, if we could negotiate a price subsidy then we would be able to have continued operation and not have to abandon the project.

Mr. **Rackley**. That's correct.

Mr. **Armey**. And this is where we are today.

As I look at this, I am obviously concerned about what we do with our resources. I am concerned about the impact of this on the State of North Dakota and the people that live there. I am concerned about the larger public interest and the taxpayers' money, as Mr. Synar is, but I am also concerned about you and your partners.

I suspect that maybe you might feel a little bit misled and misbegotten by the Government at this point. Is that a possible characterization of your feelings?

Mr. **Rackley**. I think we went into this thing together. We are disappointed that prices went down on us. We are sorry that the event occurred. It is here, the plant is built. It is out there. It is a national treasury. That facility is pumping about $200 to $230 million a year into the economy of North Dakota and the surrounding area.

It is going to be producing gas equivalent to about $230 a year of energy that we will otherwise import. We need to take this into consideration. This has not been taken into consideration in any of the numbers presented here today, is the internal generation of money. That is commerce. That is what most Americans think they are here for.

Mr. **Armey**. I want to try to gather in my understanding the interest of all the parties concerned within the context of how this came to happen.

You mention importing. Would we be importing from Canada in this case; is that what you are referring to?

Mr. **Rackley**. It would generally be importing gas and oil somewhere, either from Canada, Mexico, or OPEC countries.

Mr. **Armey**. So you are not talking about anything that is particularly localized, then?

Mr. **Rackley**. No.

Mr. **Armey**. OK.

I appreciate your testimony and I can appreciate that you might feel a bit misled and misbegotten. As I make up my mind on this matter, I certainly want you to know although my charge is to the public interest, I believe Tenneco and your partners are also included in the public, so I won't disregard your point of view.

Mr. **Rackley**. Thank you.

Mr. **Synar** [presiding]. Mr. Rackley, let me just conclude today by again thanking you for coming.

Let me try to summarize here. You have got problems. We have got problems. We have got to figure out a way to solve those problems.

What I think, if I could get out of you in these closing minutes, is a commitment to understand the problems that we have in dumping more taxpayers' money in this project; whether or not we can get a commitment out of you all, the partners, to bend a little bit on these demands. Very frankly, as a chairman who has followed this project from day one, it appears to me that you all have begun to get committed to the bottom line in next year's annual report more than anything.

As you said so many times in your statement, you believe we have shared goals. I think that is correct. But something that bothered me in your statement was that unless the sponsors get an $820 million agreement before June 15, they will initiate abandonment procedures.

Now, I don't how to read that any other way than to say that's just simple extortion. I hope it is not intended to be that. But I really believe we have got problems that we have got to deal with here. I am hoping that when I give you a chance to respond you will give me an answer that you all are committed to bending and being a little bit more flexible on this, so that we can solve the problems that you have and that we have.

Can I get that commitment out of you all?

Mr. Rackley. Mr. Chairman, I appreciate the sincerity that you have about this concern. I am here representing the management committee of the group. I will take your comments back and give them to them and take it into consideration. I cannot speak for all of them on this issue at this time.

Mr. Synar. Let me thank all the members for being here today, and let me thank all the witnesses for coming. We thank the staff for an excellent job, particularly Jim Tapper, Rick Young, and Becky Meadows for their excellent work.

I don't know what to say in the end about this. This project is something which has become an economic nightmare for this Congress and for the taxpayers of this country. I want to try to find a solution to this problem, but we are going to have to have some cooperation out of all the parties concerned. If today's hearing is any reflection of the obstacles that we face in trying to do that, we have got a major task ahead of us.

I will make a personal commitment to those who are listening to what we had to say today, that we will not spare any method, in order to try to resolve this issue. I think it is important for the country; it is most important, as that chart pointed out, to the taxpayers in this country that each one of us represent.

This concludes the subcommittee hearing.

[Whereupon, at 2 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]